Strategies to tame the inflation tiger

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by Standard Chartered's Chief Investment Office

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From my conversations with clients, the number one concern at the start of 2022 was inflation. The recent tragic events in Ukraine have amplified this, with the dramatic increase in energy prices.

In this environment, the first instinct of investors is to take money out of the markets. However, in times like these, it's important not to lose sight of the long-term investing principles learnt from decades of financial history. One of the primary lessons is that if you are really worried about inflation, the worst thing a long-term investor can do is to sell out of equities or private assets as these are the primary assets which are likely to protect against inflation in the coming decade.

How do we then position ourselves?
The first step is to have a plan. For most investors, the number one goal of an investment plan is to prepare for retirement. The challenges here are huge. Generally, the longer the horizon over which you are trying to predict, the less confidence you have in those predictions. An average 30 years old, for example, will probably have to make decisions on earning a living, accommodation, marriage, saving for kids' education and retirement planning. Too often, the complexity of decisions is such that people delay planning or give up altogether.

Inflation also has to be taken into account, especially with such long-term horizons. In Asia, inflation has eroded the value of 100 units of local currency markedly over the course of the 30 years (from 1989-2019). The "best" performers here were Taiwan and Singapore, where the currencies' value has "only" fallen 38 and 39 per cent, respectively. At the other end of the scale, you have Vietnam, Indonesia and India, where currencies have lost around 90 per cent of their local purchasing power over the same period.

Against this backdrop, most financial asset classes, with the exception of cash and deposits, have delivered returns that have retained purchasing power. Global equities and private

equity have led the way, delivering an annualised return of 8.5 and 13.6 per cent, respectively, in the 10 years to September 2020, handsomely beating inflation.

Bonds have also done well since the early 1980s as central banks declared war on inflation and structural disinflationary pressures kept the downtrend on interest rates and bond yields intact.

We believe it is getting harder and harder for bonds to generate strong returns going forward and outpace inflation. Lower starting yields mean that bonds will likely lose purchasing power for investors, even assuming inflation normalises back towards 2 per cent. Even higher-yielding or sub-investment grade bonds are expected to return just over 2 per cent per annum over the next 7 years.

For investors looking to beat inflation, we have some good news. First, we expect equities and private assets to continue to provide a good hedge against inflation in the coming years. This is shown in the table below, which is a key input into our robust asset allocation process.

Second, in financial markets, the longer your time horizon, the greater the confidence you can have in the expected outcome.

Finally, long-term expected returns have generally proven to be reasonably accurate and therefore can be used as a decent yardstick when it comes to planning ahead.

Domestic purchasing power lost over the past 30 years

	1989	1999	2009	2019
China	0	-51	-60	-69
India	0	-59	-77	-88
Indonesia	0	-72	-88	-92
Malaysia	0	-33	-45	-56
Vietnam	0	-79	-90	-94
Hong Kong SAR	0	-45	-46	-61
Korea	0	-42	-57	-64
Singapore	0	-16	-28	-39
Taiwan Province of China	0	-25	-31	-38
United States	0	-25	-42	-51

Source: IMF World Economic Database (October 2021), Standard Chartered

Standard Chartered's expected annual returns for the next 7 years

	Expected Return (Annualised, %)	Expected Volatility (Annualised, %)
Global equity	5.4	19.2
Global bonds	1.0	6.0
Global high yield bonds	2.3	9.5
All commodities	0.9	27.4
Gold	0.2	15.0
Liquid alternatives	4.0	5.0
Private equity	8.4	21.9
Unlisted real estate	5.9	14.7
Private debt	5.3	11.7

Source: Mercer Consulting, Standard Chartered

1. **Have an investment plan**
2. **Stayed invested with a long-term horizon**
3. **Long-tem expected returns can be used as yardstick when planning ahead**

What our analysis also shows is that future returns are likely to be lower than those in the past decade. This makes it even more important for investors to focus on building foundation allocations centred around global equities and private market assets. Thus, short-term weaknesses in equity markets should be used as an opportunity to increase exposure to equities where appropriate.

Far too many investors have excessive cash holdings or are too reliant on bond investments. If this remains the case, I believe it would be a major contributor to people losing their purchasing power to inflation and not achieving their financial goals.

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