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Inflation…in context

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It's inflation day today. So, you'll see many broadcasters publishing 'breaking news' with headlines such as "prices rise at fastest rate for 30 years".

Now, inflation will be incredibly important for investors over the next decade, and beyond. The inflationary environment dictates which assets do well or badly, impacts the path of economic growth, and most significantly, sets the hurdle which investors need to beat to preserve the value of their cash.

So, on the 7IM Investment Management team, we spend a lot of time thinking about inflation and its consequences. And to be clear, **we think that inflation is likely to be higher over the next ten years than it has been previously; bouncing around *above* 2%, rather than around 1%.** That has vital implications for how investment managers think about portfolios.

Before I get to that, I want to try and put some context around 'inflation' – and the report which came out today from the Office for National Statistics.

This inflation isn't new

Technically, the headline isn't wrong. The 12-month increase in UK consumer prices to March *is* the largest we've seen since 1992 – whether you're looking at the CPI number (7%), the RPI number (9%) or the government's preferred CPIH number (6.2%).

But the headline isn't *news*, let alone breaking news.

Last month's inflation numbers were *also* at a thirty-year high. As were January's. And December's. The figures have been rising sharply since the summer of 2021. The technical fact of "another new high" doesn't really add anything to the existing picture…

Consumers across the country already know all about rising inflation. As individuals, we don't need to wait for an 'official' number[1] to know whether our costs of living are going up. We've all been to the supermarket, or DIY store, or airport, or petrol station. We've all been aware of the rising cost of energy across the world; and the increase in the energy price cap in April[2] (not in these recent figures) has been common knowledge for months. People have been making adjustments – some of them very difficult – already.

And what the public knows, policymakers also know. The data has been clear for months. The Office for National Statistics was already conducting impact assessments on the cost of living in January. The Bank of England has been increasing interest rates precisely to try and rein in further inflationary tendencies in the economy. The government's Spring Statement was almost entirely aimed at the issues surrounding the cost of living.

Companies are responding, too. The likes of Tesco, Sainsbury's and BT have given their employees the most significant pay rises in years, and the National Living Wage has just increased by 6.6% to £9.50 per hour.

This highlights that while inflation is absolutely a key concern for all parts of the UK economy (and indeed most of the developed world), it's not a *new* problem. It's been in the public consciousness for many months, and action is already being taken in all parts of the economy – whether that's increased investment and innovation to address supply shortages, shifting consumer demand habits, or the changing interest rate environment.

[1] And as I've said previously, the official number doesn't really reflect individual spending habits https://www.7im.co.uk/financial-adviser/news-views/investment-update-q1-2022

[2] https://www.ofgem.gov.uk/publications/price-cap-increase-ps693-april

Investing for inflation

Some of the recent pressures on inflation are likely to fade as we move towards the end of 2022; particularly those related to COVID-19 supply chain issues, and (we hope) those related to the conflict in Ukraine.

But we believe that inflation is likely to remain above 2% in the developed world, reflecting an increased level of demand fuelled by strong consumers, supportive governments and confident businesses.

Leaving the mushy malaise of the last decade is no bad thing; the scars of the financial crisis are finally healing, which should ultimately be a positive for the whole economy. But some asset classes are still quite far from pricing a new decade of higher growth and higher inflation.

The most notable winners of the last decade were government bond markets and US equities (especially the technology companies), while the laggards have been emerging market assets, alongside banks, and energy/ mining companies.

Our portfolios favour the unloved equity assets from the previous cycle, and we're seeing that the momentum has already begun to shift, with a long way still to go. We also keep our meaningful tilt away from bonds, which has already avoided a lot of the pain from rising interest rates. Again, we believe there's more to come, and prefer to use a basket of alternatives strategies to offer stable returns and defensive characteristics.