M&G Insights

M&G Investments

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Don't let rising inflation deter you from investing

With global and local inflation rising sharply, some investors may be considering reducing or even pausing their investment contributions to help ease the strain of rising costs. This may seem like a good idea over the short term, but it's important to remember that the value of your investment (and money) will need to grow at the same rate as inflation to retain its purchasing power. This means that by reducing or pausing your investments, you could potentially end up in a worse-off financial position over the long run.

It's not surprising that individuals may be tempted to invest less. In South Africa, headline inflation (CPI) rose to a 13-year high of 7.4% at the end of June, with the average cost of a household food basket increasing by 14.8% or R611.44 from July last year to July this year. This is a big jump for local consumers, who have benefitted from the SA Reserve Bank keeping inflation well-controlled within its 3%-6% target range over the past several years. Low global inflation has also helped considerably.

Real returns are vital

When it comes to investing, you've probably heard the term 'real return'. This is the rate of return at which your investment grows relative to inflation. For example, if the inflation rate is 7.0%, your investment will need to grow by the same amount or more to generate a positive real return. Conversely, if your investment return is less than 7.0%, the real return on your investment would be negative even if the absolute return is positive. This is an important distinction to note, as some banks may offer you a positive fixed rate on your fixed deposit investment that's actually less than inflation. In this case, even though your money is growing, it's not growing enough to keep up with the rate at which the cost of goods is rising

When you're investing towards a medium-to-long-term goal, such as your child's university education or your retirement, it's important to ensure that by the time you need your money, the growth of your investment value has kept up with inflation. Not doing so could mean that you wind up being unable to afford the cost of your goal when the time arrives.

And don't forget about compounding. So long as you continue to re-invest the income distributions on your investment (instead of having them paid out), you create a larger base from which future investment returns can accumulate. This is another good reason why pausing or discontinuing your contributions to your existing investments can have a deleterious effect on your financial goals. Not only will continuing to invest increase your capital base, but it will also increase it exponentially, thanks to the power of compounding. Have a look at our article How to Compound your Wealth for a fuller explanation.

Invest to outstrip inflation

This is where investing with an experienced asset manager, such as M&G Investments, with a sound long-term track record of selecting the right stocks and out-performing inflation, is so important.

The M&G Inflation Plus Fund, for example, aims to outperform CPI by 5% (before fees) over a rolling three-year period. The M&G Balanced Fund is another sound choice with slightly higher equity exposure. While it doesn't have an explicit inflation target, the fund has consistently beaten inflation since its inception.

Will inflation keep rising?

In the latest statement from the Monetary Policy Committee (MPC), the South African Reserve Bank (SARB) revised its forecast for 2022 headline inflation to 6.5% by the end of the year. As this is lower than June's 7.4% y/y, it means that the SARB expects inflation to moderate going forward.

Whatever the final figure turns out to be, the important point to understand is that inflation moves in cycles along with economic growth. As prices increase, so consumer spending starts to slow, and this eventually sews the seeds of price declines (called "demand destruction"). Central banks will also hike interest rates to curb inflationary pressures, slowing economic growth and inflation. Once inflation falls back to levels satisfactory for central banks, they then cut interest rates, and growth accelerates again. Consequently, if you do stop investing when prices rise, you should make an effort to invest more once conditions improve.

Hopefully, we've explained why it's crucial to continue to invest irrespective of inflation, and to factor in inflation when planning your medium-to-long-term investment goals. Although markets remain volatile, selecting a fund manager you can trust, with a solid track record of producing consistent returns, is key.

For more information on investing with M&G Investments, please feel free to contact our Client Services Team on 0860 105 775 or email us at info@mandg.co.za.