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How investors can guard against lasting inflation

by Stefan Hofrichter, CFA , Martin Hochstein, CFA | 04/11/2021

Summary

How can investors reposition their portfolios in the face of a persistent rise in consumer price inflation? In part two of a two-part paper, we share the results of our proprietary analysis into the asset classes that may provide an optimal inflation hedge.

Key takeaways:

- Given our view that inflation is set to last longer than many market watchers expect, we conducted our own analysis into how different asset classes performed in a range of inflation environments
- Our research found that with moderate inflation (2%-4%), equities were the top-performing asset class, and sovereign and corporate bonds both generated decent positive annual real returns
- Perhaps surprisingly to those who consider gold to be the ultimate hedge against inflation, gold's returns were mixed across different inflationary environments
- Commodities consistently generated solid positive returns in times of high and rising inflation, but their longer-term outlook may be obscured by the transition away from fossil fuels

In our view, global central banks and many investors underestimate the probability that consumer price inflation may turn out higher than expected and last longer than currently priced into financial markets. While we don't foresee a return to the price environment of the 1970s, we think medium-term inflation risks are nevertheless skewed to the upside, and we may see a more regular overshooting of central banks' inflation targets over time. This is contrary to the consensus scenario (and the view of most central banks) that the rise in inflation is just a temporary phenomenon – a perspective that we think is a bit too sanguine. To learn more about the eight factors driving inflation higher, read Inflation: beyond transitory.

As a result, we believe investors should take a closer look at how their portfolios are positioned to hedge against inflation. In seeking to determine some of the optimal ways to provide this hedge, we conducted our own in-depth analysis of a range of asset classes. Explore the four sections below to see the results of our findings.

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1. How can inflation affect bond and equity prices?

2. What are the most attractive inflation hedges?

3. What are the top implications for investors?

4. Appendix: Want a closer look at four key findings from our research?

→ FIND OUT MORE ABOUT THE EIGHT FACTORS DRIVING INFLATION HIGHER

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Two bond market ideas to help guard against rising inflation

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Summary

After many years of falling inflation, the second half of 2021 could be remembered as the time when prices started to rise again. How should bond market investors respond? Here are two more ideas.

Key takeaways

- Higher-than-expected inflation has surprised markets in the second half of 2021, and it could be more prolonged than many expect.
- As inflation erodes bonds' real returns, a long-term investment strategy should seek safeguards.
- Two possible options are inflation-linked bonds and floating rate notes.

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