SAFETY ▪ STRENGTH ▪ STABILITY
UNIT TRUST CORPORATION
ADVISORY SERVICES DEPARTMENT

Newsletter

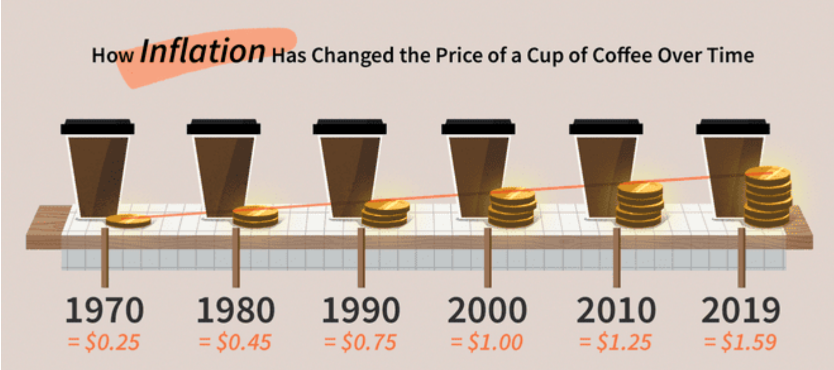
www.ttutc.com/advisory-services
Q1 2022 | Issue 28

INFLATION AND YOUR INVESTMENTS

As a result of the Covid-19 pandemic which caused major disruptions to the global economy, inflation, a key economic indicator, was given more focus. From the macro level to an individual one, inflation impacts just about everything. It measures the general increase in the price of a set of goods and services over a specified period, usually one year.

As a currency loses value, prices rise, thereby decreasing purchasing power and the number of goods and services that can be bought. This, in turn, impacts the general cost of living for the public as shown in the change in the price of coffee over time in Chart 1.

Chart 1: Change in the price of coffee overtime

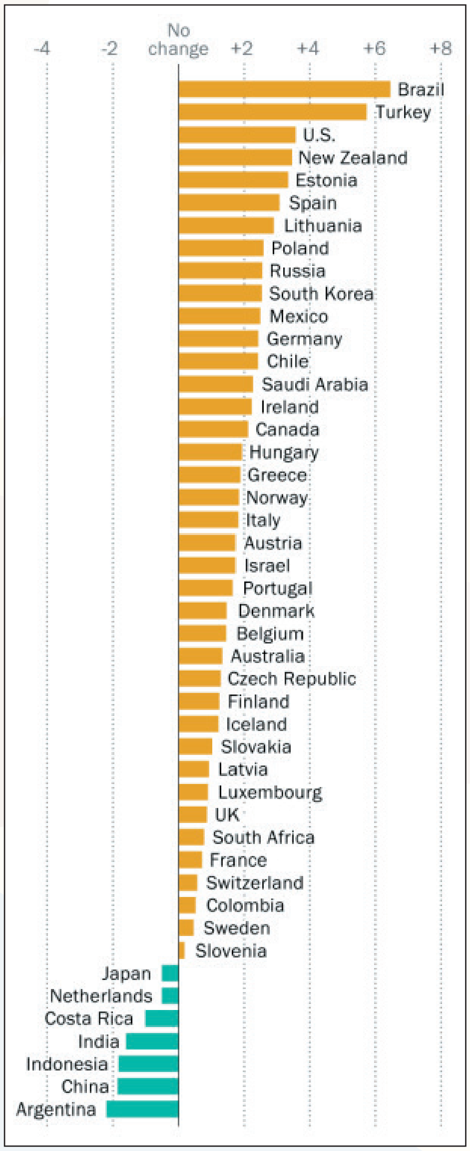


Source: Investopedia

Inflation is not always bad as moderate levels are necessary to drive consumption which is crucial for the economy to grow. However, when inflation becomes too high, it can destabilise an economy and can create financial challenges.

Across the globe, many countries have seen an increase in the rate of inflation. A study conducted by PEW Research Center showed that Q3 2021 inflation was higher in 39 of the 46 countries when compared to the pre-pandemic Q3 2019.

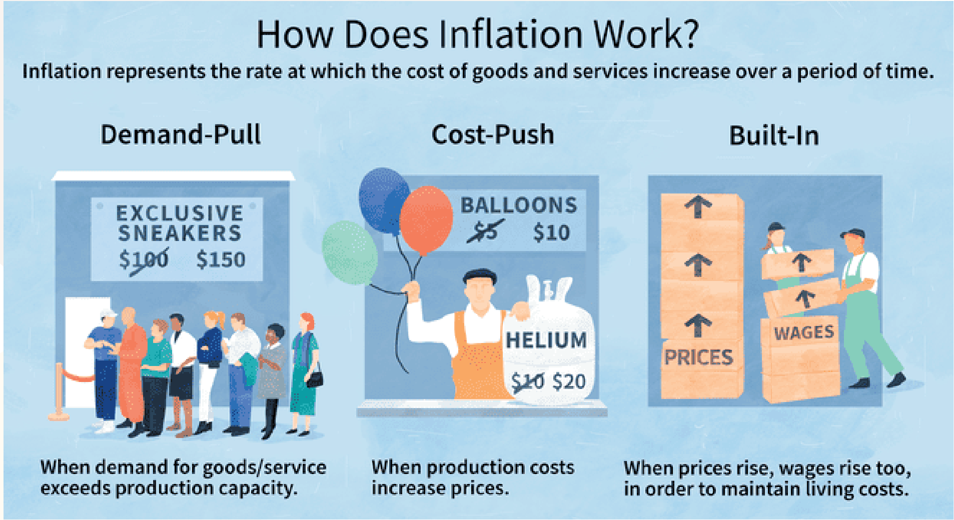
Chart 2: Percentage Change in Annual Inflation Rate between Q3 2019 – Q3 2021



Source: PEW Research Center analysis of Organisation for Economic Co-operation and Development data

Many factors can cause inflation, but they generally fit into one of two main categories – demand-pull or cost-push inflation. Demand-pull inflation usually occurs when economic activity increases. The labour market is strengthened resulting in increased income thereby causing the demand for goods and services to rise. When consumer demand exceeds supply, prices increase. On the other hand, cost-push inflation is caused by the increased cost of raw materials during the manufacturing process. When companies are unable to absorb this increased cost, it is passed to the consumer as a price hike.

Chart 3: Causes of Inflation

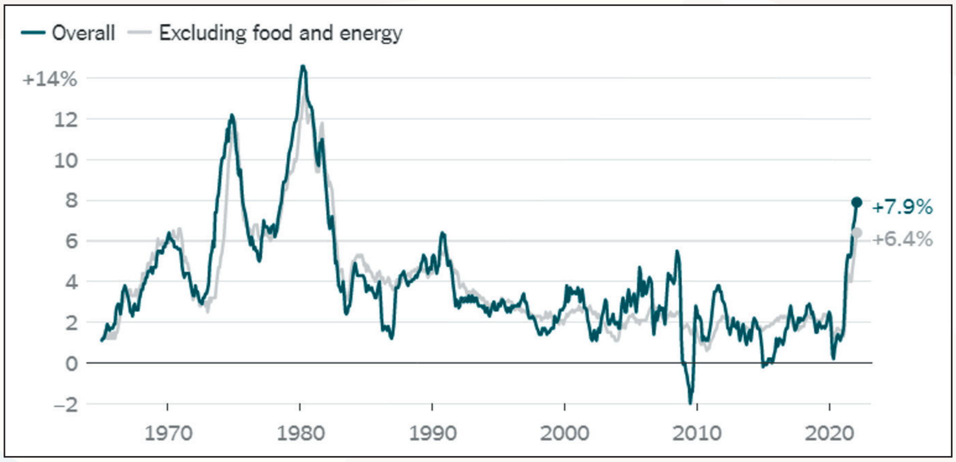


Source: Investopedia

As a result of the pandemic, economies experienced both demand-pull as well as cost-push inflation. As the economy reopened, there was greater demand for goods and services with persons spending the savings they accumulated during lockdown periods. Companies were also forced to limit production and were unable to meet the demand surge as there were supply chain issues as well as shortages of vital production inputs.

The inflation rate in the US has been steadily rising from March 2021's low of 2.6%. In February 2022, the Consumer Price Index (CPI), the most commonly used inflation index, rose by 0.8%, resulting in inflation hitting a 40-year high of 7.9% year on year – the highest on record since January 1982.

Chart 4: Inflation in the US - Year-over-Year Changes in the Consumer Price Index

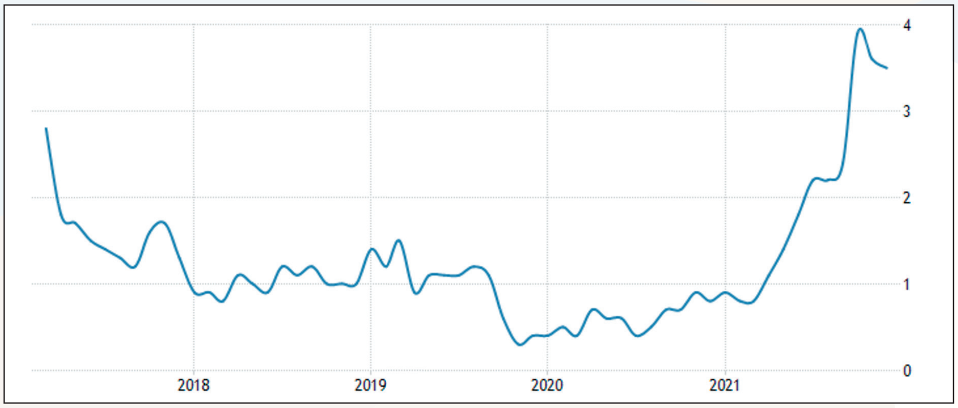


Source: Bureau of Labor Statistics by the New York Times

Inflation has also increased here in Trinidad and Tobago. Headline inflation is a metric which measures the total inflation in an economy. It includes the highly volatile commodities of food and energy and measured 3.5% year-on-year as at December 2021. This represents a 0.1% decrease from November 2021 but is still significantly higher than the 1.8% reported for June 2021.

Food inflation also followed a similar pattern. In December 2021, food inflation also declined slightly from 5.9% year-on-year in November 2021 to 5.7% in December 2021 but was still higher than the 5.1% recorded in June 2021.

Chart 5: Inflation in Trinidad and Tobago



Source: Central Bank of Trinidad and Tobago, tradingeconomics.com

Inflation-Buffer Your Investment Portfolio

Inflation does not only affect consumer prices, but it is also a concern for investors as it erodes purchasing power; it makes money saved today, less valuable tomorrow. For example, if the return on an investment was 5% but the inflation rate was 3%, after adjusting for inflation, the investor only earned 2%. It is therefore important to ensure that your investment strategy enables the return on your portfolio to be able to outperform, or at the very least, keep up with inflation. In essence, it can be considered a benchmark. The assets that thrive best under inflation are those that bring in more cash or rise in value as inflation increases.

Fixed Income

Fixed income investments are not considered optimal to hedge against inflation as the returns may not be able to match the rise in prices. Additionally, central banks tend to use interest rates as a tool to combat inflation. Therefore, in an inflationary environment, interest rates are expected to eventually rise, thereby negatively impacting fixed-income securities.

Equities

Equities, on the other hand, provide more protection and have a reasonable chance of helping to keep pace with inflation. It is expected that a company's revenue, after a period of adjustment, will grow alongside rising inflation. However, not all equities are created equal. It is best to focus on companies that have better pricing power or inelastic demand which enables them to align the prices of their goods and services with inflation.

Stock Markets

The US stock market performed exceptionally well in 2021:

- The S&P 500 gained 26.89%
- The Dow Jones Industrial Average (DJIA) gained 18.7%
- The Nasdaq Composite gained 21.4%

These returns outperformed the US inflation rate which stood at 7% at the end of 2021.

Similarly, the Trinidad and Tobago Stock Exchange (TTSE) returned a positive performance in 2021:

- The Composite Index of the TTSE recorded 13.14%
- The All T&T Index returned 17.61%
- The Cross-Listed Index returned 3%

The returns of the Composite and All T&T Index were able to outpace the inflation recorded for 2021.

Real Estate

Real estate is another option as it typically does well during periods of high inflation when the value of property, as well as rental income, can increase. Homeownership is not the only option; real estate investments can be made by buying shares in a Real Estate Investment Trust (REIT) or through mutual funds that invest in REITs.

Investors also tend to move to commodities such as gold, when inflation picks up as they are tangible assets and are likely to increase in value. They have also historically done well in high inflation. In contrast, exchange-traded funds (ETFs) investing in commodity futures will tend to underperform the price of a rising commodity, because their futures positions must be rolled as they expire.

There are, however, no guarantees. Typical strategies to mitigate against inflation don't always work, and there may be unique economic conditions that can deliver surprising results and switch the assets in the winner's circle.

Investment Check List

This recent surge in inflation is a good opportunity for investors to review their investment portfolios to determine if their current asset allocation still allows them to meet their financial goals. Below are some points to consider:

1. **Do not overreact**

   Just because inflation is high at the moment, there is no need for any rash decisions. It may not be necessary to completely overhaul your entire portfolio, some minor tweaks may be all that is needed.

2. **Review historical data**

   Even though past performance does not guarantee future returns, how your investments performed in the past during high inflationary periods, might provide some insight as to what they might do this time around.

3. **Ensure diversification**

   You want to ensure that your portfolio has a wide variety of investments spread across and within asset classes to limit any exposure and lower the risk of any individual security. In the end, the positive performance of one portion of the portfolio would be able to outweigh any negatives in another.

4. **Talk to the professionals**

   If it seems like a daunting task, feel free to reach out to your financial advisor who can answer any questions and help guide you to make the best decision for your portfolio.

Mail: Mrs. Linda Wilson-Mano
Assistant Vice President
Advisory Services Department
3rd Floor, UTC Financial Centre
82 Independence Square
Port of Spain

Tel: 624-8648 Ext. 3013

Email: yourwealthmanager@ttutc.com

www.ttutc.com/advisory-services

About the Advisory Services Department

The Advisory Services Department of the Trinidad and Tobago Unit Trust Corporation was established to serve our valued clients seeking financial and investment advice and solutions from a trusted service provider. We will assist you in enhancing your personal wealth and financial well-being by providing you with financial counselling, investment advice and solutions.

Partners for Life