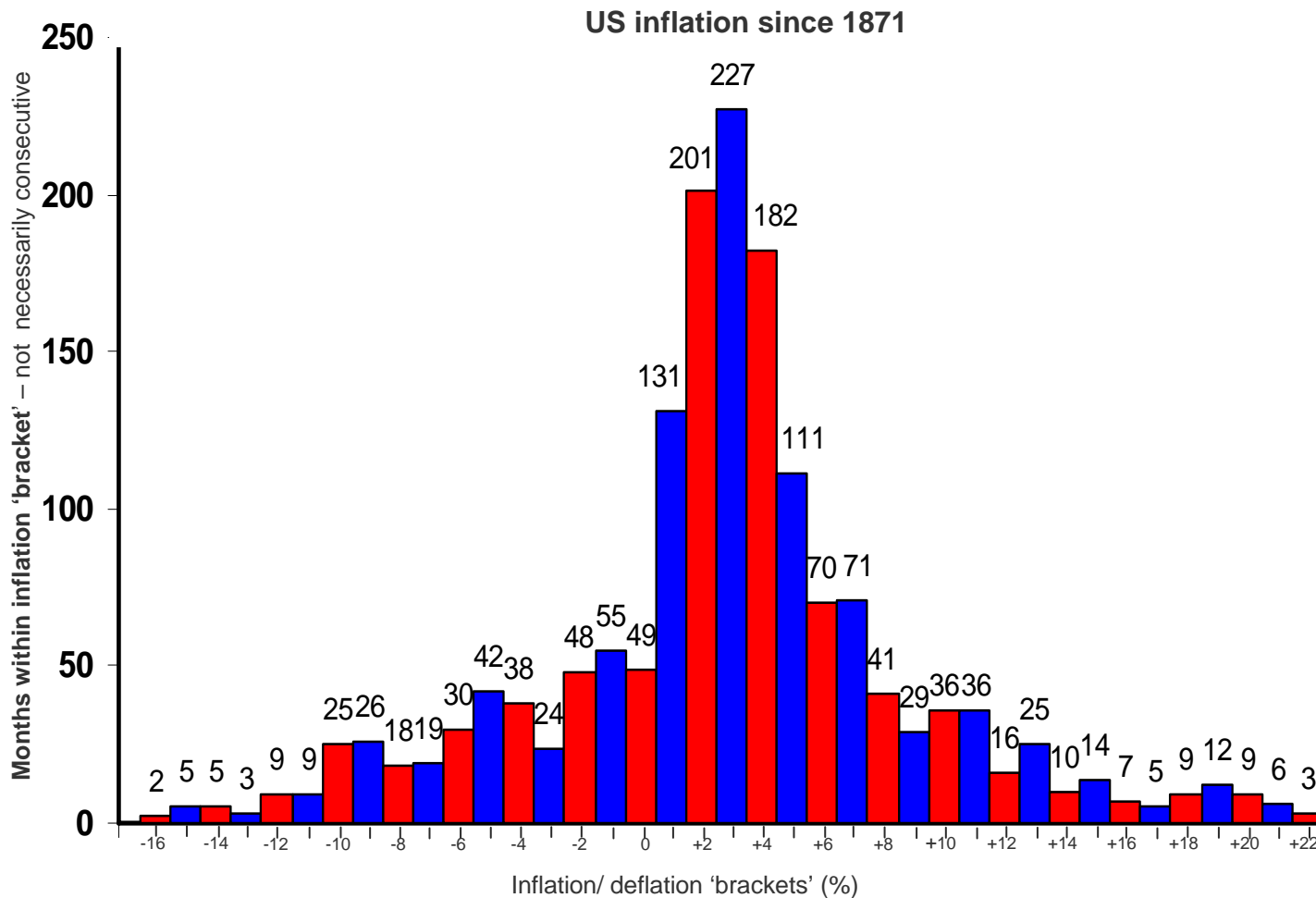


Assessing the inflationary risks

AT A GLANCE

JANUARY 2010



- Inflation, in the most part, has been well contained throughout history
- Low levels of inflation are considered attractive, as they are typically associated with better investment returns than high inflation or deflation.
- Hyper-inflation and deflation are obvious concerns for policy makers
- Although this chart examines US inflation, the high level of correlation between inflation levels globally would suggest that the conclusions are equally applicable to other developed economies
- The last 138 years have seen 58 months with deflation of 10% or greater and 185 months with inflation of 10% or greater
- There is uncertainty about what inflation will look like in the coming year.

Source: Factset and Haver Analytics, December 2009

Whatever the answer to the inflation question...

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- ▣ As we move into 2010, inflation is a topic that is likely to receive much attention from investors
- ▣ After a short period of price declines in many markets, inflation is once more returning
- ▣ As central banks exit their quantitative easing programmes, there is an awareness of the timing risks involved
 - ▣ Exit too fast, too early and the nascent recovery may be choked off
 - ▣ Exit too slowly and the risk is that inflationary pressures will build out of control
- ▣ There are several ways to protect an investment portfolio from inflation
 - ▣ The most obvious is to own financial assets that are expressly designed to offer protection against rising prices. Inflation linked bonds would be a good example
 - ▣ Another approach would be to own assets which benefit from the causes – or, indeed, are the causes – of that inflationary pressure. These could be broadly termed as “real assets” (the likes of commodities). Owning shares in companies that produce or invest in these assets is an alternative approach
 - ▣ For those who suspect that inflation may be a risk but aren’t sure of the timing of that risk or of its extent, a well-diversified portfolio makes sense. Asset allocation flexibility is a key consideration if your views are not strongly formed at this time

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