

WEALTH **BULLETIN** DOW JONES

How to fight inflation

By James Rutter



Living the good life is getting more expensive. If the rocketing prices for fuel and food weren't bad enough, research suggests inflation for the wealthy often runs at more than double the rate suggested by official measures. As far as wealth preservation is concerned, it presents a stiff challenge. Guy Monson, managing partner at Sarasin & Partners, said he regards inflation as "enemy number one" for clients.

"BEATING INFLATION MEANS TAKING MORE RISK. THE ALTERNATIVE MAY BE TO SPEND LESS"

With inflation generally on the rise, constructing a portfolio to deliver real returns – performance above the rising cost of living – is essential. The first challenge is to pick the right target to beat.

ASSET ALLOCATION

Inflation-proof your portfolio

Cheviot Asset Management

50% equities
25% cash and bonds
15% hedge funds
10% private equity and commodities

Wealth adviser Stonehage did a research study last year to assess the true rate of inflation for wealthy Londoners. The firm's affluent London living index was compiled from tracking the price of luxury goods regularly purchased by its clients, including everything from school fees to the price of yacht charters and caviar. It showed living costs rising at an annual rate of 6% last year – nearly three times the official UK measure. The index was updated recently (after Wealth Bulletin went to press) and Stonehage will be adding a Swiss version.

Robby Hilkowitz, partner at Stonehage, said: "If you underestimate inflation, you very quickly get severe capital erosion." He said a realistic goal for a wealthy family is to double their real capital base, after inflation and spending, every 25 years. A family with £50m that assumes they need only beat CPI could see a shortfall in real capital of £46m over 25 years.

Private bank Coutts has a similar measure it calculates by tracking the expenditure of clients using its credit cards. Last year, it suggested a rate of

inflation of 9.5% for someone spending all their disposable income on luxury goods: “Of course, not many clients do but plenty are probably experiencing inflation of 7% or so,” said Carl Astorri, head of strategy at Coutts.

To deliver a return to beat this lifestyle inflation rate requires asset allocation to involve plenty of equities, private equity and hedge funds, added Astorri, not just low-risk cash and bonds: “Otherwise clients will see their lifestyle eroded.”

Equities in the long run have delivered an average return of about 10%, while private equity has generated the best return over long periods, delivering 3% or more above listed equities.

David Miller, head of alternative

investments at Cheviot Asset Management, believes a sensible asset allocation for an inflation-proof portfolio would have half the assets invested in stock markets, 15% in hedge funds, 10% in other alternatives such as private equity and commodities, and the remainder in cash and bonds.

Holding some inflation-linked bonds probably makes sense, said Alex Claringbull at Barclays Global Investors, although they are currently expensive. Exchange-traded funds can offer an easy way to play the market.

Commodities are often seen as an obvious inflation hedge but Astorri said Coutts is recommending investing only a small portion in long/short hedge funds

in the sector. “We are concerned about a potential bubble.”

The emergence of funds that have inflation as a benchmark – albeit an official rather than a lifestyle measure – can simplify matters for investors, said Sarasin’s Monson. Such funds, investing across asset classes to deliver between 3.5% and 6% above UK retail price inflation, have been Sarasin’s fastest-growing business.

The uncomfortable truth, said Hilkwitz, is that generating higher returns to combat inflation requires taking more risk. The alternative is to accept what may be an even less palatable fact, he added: “Perhaps you just have to spend less.”