INVESTMENT REPORT

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# CASH AND THE LURKING INFLATION MONSTER

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**The S&P 500 Index reached a (new) all-time high of around 4 800 towards the end of 2021, before the latest market pullback. Whilst the reasons as to why the index has had a pullback are well documented, many have resorted to 'panic selling' and cashing in, and those who were already in cash, simply opted to continue with the same.**

However, once you take into consideration that there has been a total of 39 market corrections (a drop of 10% or more) for the index since 1950, or on average at least one every two years, it shows you that there have always, without exception, been opportunities for investors in times of panic and distress.

If this wasn't the case, we would never have reached what they refer to as "an all-time high", as recently as two or three months ago. Or, for that matter, any new all-time highs. The mere fact that indices such as the S&P 500 reached NEW all-time highs, is clear proof that market corrections/pullbacks present the perfect buying opportunity for investors, enabling them to enjoy the ride to the top. Because it certainly will happen.

Ironically, it is in times of chaos that opportunity presents itself, especially for those investors with available cash. Recently, specifically the week of 14 – 18 March 2022, saw the S&P 500 index boast a weekly gain of just over 6%, yet the index is still comfortably below its highs. This means opportunities will always be available for those who can stomach the inherent volatility of equity markets and patiently stick to a long-term plan.

## IN THIS ISSUE

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## INVESTORS WHO ARE CURRENTLY SITTING WITH CASH, ESPECIALLY IN THE CURRENT LOW INTEREST RATE ENVIRONMENT, MAY BENEFIT FROM CONSIDERING ALTERNATIVE OPTIONS:

### OPTION 1: CONTINUE WITH CASH

This is, of course, the most obvious option. In the short-term, it protects against market volatility and uncertainty. **However, cash unfortunately cannot achieve inflation-beating returns in the long run.** It is imperative to consider further options and be comfortable with taking on a bit of risk.

### OPTION 2: INCREASE EXPOSURE TO EQUITY

With a relatively strong rand and with the recent correction in offshore markets, now may be a great time to 'buy during the dip' and increase exposure to offshore equity. It is the proven method to achieve inflation-beating returns in the long run. However, one needs to invest according to your risk profile and to understand the risks that come with being invested in and having exposure to equity.

### OPTION 3: PURCHASE PROPERTY

Apart from certain bubbles in South Africa, the property market has been stagnant, at best, over the past five or so years. What traditionally was a very 'safe' form of investment, has become a thorn in the side of many South Africans, when you consider the rapid increase in rates and taxes, levies, etc., with the addition of other taxes, such as transfer duty and capital gains tax (if you are lucky). Although it is always an option to expand your property portfolio, it isn't necessarily as 'clear cut' as it may have previously been in South Africa, especially in the years when property was booming and we had an economy that wasn't contracting in real terms. Another big disadvantage of investing in property is that it is not a very liquid investment.

### OPTION 4: INVEST IN INCOME FUNDS

Income funds are a great alternative for conservative investors who are uncomfortable with exposure to equity markets, but desire better returns than provided by cash and an investment than is far more liquid than property. Brenthurst has made use of local income funds for several years, with remarkable success. Some of the funds we use have consistently produced returns of inflation plus 3% – 4% per year, with less volatility and reduced risk involved, when compared to equity funds. This type of fund is an excellent alternative for investors not wanting to adopt a lot of risk, but who would still like to achieve returns of 3% above inflation.

If investing in equity markets are too risky for you, Option 4 will, without a doubt, be the more suitable solution, instead of sitting with cash.

## INFLATION IS LURKING AND YOUR CASH INVESTMENTS WILL HAVE NOWHERE TO HIDE:

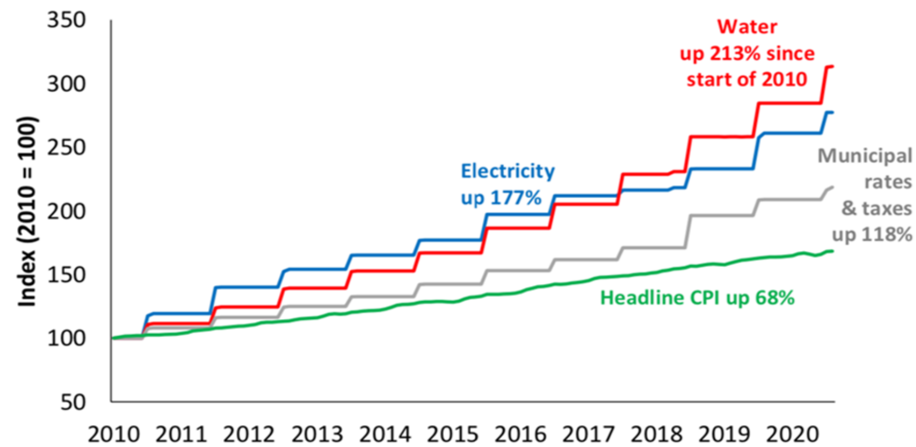
**With inflation reaching 40-year highs in America and 30-year highs in the UK, and the war in Ukraine persisting and disrupting supply chains and oil prices worldwide, you can be sure that inflation in South Africa will rise beyond the current 5.9% for March 2022, as published by Stats SA.**

**If you think of a basket of typical products that consumers use daily, such as basic food, clothes, entertainment etc., all of these have two main drivers of their input price:**

- **Fuel, to transport the various products to the required locations.**
- **Electricity, to run production processes to produce the final product/food.**

The prices of these two elements have risen much faster than other items in the inflation basket, well above 10%, even before the pandemic and war broke out. Therefore, you can bet your last penny that actual inflation for the man on the street, who likes to have a cold beer over the weekend whilst braaiing A-grade steak and commutes in a Toyota Fortuner, will definitely consume products and services at inflation closer to 10%, and easily beyond that. *If you need proof, have a look at the following graph.*

## MUNICIPAL ADJUSTMENTS

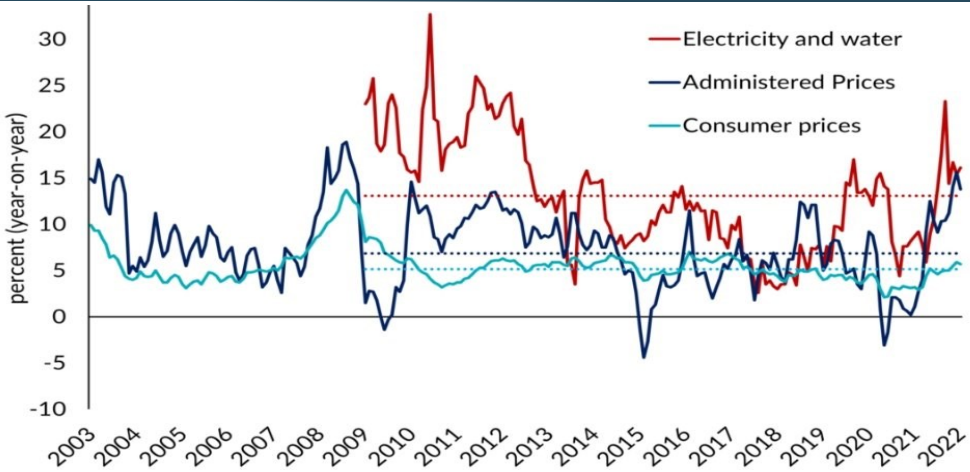


Adjustments are surveyed in July and Aug of each year. Source: Stats SA and SARB

**ELECTRICITY 6.2%**
**WATER 10.1%**
**RATES & TAXES 4.6%**
**HEADLINE CPI 3.1%**

**IT IS EVIDENT THAT THERE IS A SIGNIFICANT DIFFERENCE BETWEEN THE HEADLINE INFLATION OF 5.9% AND INFLATION ON PRODUCTS WE ACTUALLY CONSUME.**

## GOVERNMENT INFLATION RATES COMPARED TO CONSUMER INFLATION




Source: SARB, Statistics South Africa. Dotted lines denote average since January 2009. Consumer inflation is CPIX for metropolitan and other urban areas up to December 2008. Headline CPI for all urban areas from January 2009 onwards.

**It is this mentioned fact that makes it all the more crucial for investors to look for alternative investment options, other than cash or money market investments.**

**Inflation can and will have a far greater influence on your investments in the next 12 – 18 months than in previous years, and there will be only one winner between inflation and cash investments.**

**Even if you are a risk-averse investor, there are alternative options available at the same level of risk as cash/money market investments, but with higher yields.**

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