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Inflation has dominated financial news since the start of 2022. Globally inflation has reached the highest levels in decades. It is also the one economic indicator that has a significant impact on investment outcomes.

Josh MacRae explains why this is a key benchmark to consider when reviewing portfolios.

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INFLATION - THE BEST BENCHMARK FOR PORTFOLIO PERFORMANCE

By Josh MacRae, Financial Advisor Brenthurst Wealth Cape Town

With [rising inflation](#) making headlines around the globe, many investors are wondering how to reposition or rebalance their portfolios in response. One of the more important questions they must ask themselves is how to measure the impact of a change in strategy.

In technical parlance, they're looking for appropriate benchmarks against which to measure the appropriateness of their investment choices. Benchmarks are finely interwoven into the investment decision-making process because they offer a reliable point of comparison to measure performance.

THE "WHAT AND WHY" OF BENCHMARKS

Commonly used benchmarks include the JSE ALSI which encapsulates the performance of the All Share Index, or the S&P500 which tracks the performance of 500 large US-listed companies. A popular benchmark for South Africans is the MSCI Emerging Market Index because that offers a comparison against other developing economies, such as ours.

As you'd expect, the world market is awash with thousands of market indices that you can select as a benchmark. Every conceivable asset class, country and investment style is available. Such an array of benchmarks offers valuable insight into market sentiment and overall direction if you're trying to figure out what markets are doing.

But for your purpose as an investor, they tend to play a more pressing role as a yardstick of your portfolio performance.

WHY PORTFOLIO MANAGERS USE BENCHMARKS

The main role of any chosen benchmark is to offer your portfolio manager a starting point from which to build your investment portfolio. Benchmarks are an easy reference around which you can build your own portfolio and make changes to replicate the performance of the benchmark.

Using an easily recognisable benchmark helps you and fund managers track how well your investment is doing compared to a section of the market. The first prize for fund managers is to outperform their benchmarks, meaning they generate a better return than what the benchmark has achieved.

Benchmarks are also used to set performance fees, which are calculated as a proportion of the margin by which the benchmark has been beaten.

WHICH BENCHMARK IS BEST TO USE?

At the end of the day, the choice of a benchmark is somewhat subjective. I'm not suggesting any manipulation by fund managers, but given a choice they would be inclined to choose a benchmark they're confident they can beat.

However, I do believe that the only true benchmark you should consider is inflation. I say this because it's the greatest long-term threat to the value of your portfolio.

Your portfolio can beat your chosen benchmark all year long, but if your return isn't delivering above-inflation returns, after fees, then you're on a losing wicket. And at a time where inflation is climbing rapidly, I believe this measure takes on even greater importance.

Rising inflation will hopefully also be a call to action for the many investors who have shied away from the market volatility over the past number of years. Last year alone, [SA Interest Bearing Variable Term funds attracted R29,7 billion](#), the greatest proportion of retail investments.

With [consumer price inflation](#) touching 6%, these investors are going to need a healthy return to turn a profit, after taking fees into account. For long-term returns that will comfortably beat inflation and absorb fees, equities remain your best option.

Adopting this lens when you review your portfolio this year should give you a fair perspective on how well you're positioned to combat the impact of inflation. I'm not suggesting you load up on stocks only. For the majority of our investors we advocate a balanced, well-diversified portfolio as the best route to follow.

As such, I'd like to encourage you to insert inflation into your equation when measuring the performance of your investment portfolio.

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JOSH obtained his BCom degree in the College of Law at the University of South Africa (UNISA) and is a Financial Advisor under the direct supervision of BWM Managing Director and CERTIFIED FINANCIAL PLANNER®, Brian Butchart.

Josh is an ambitious, hard-working individual with over five years' experience in the financial planning industry.

His expertise includes financial and retirement planning, offshore investing and estate planning.

He is currently studying to complete his Postgraduate Diploma in Financial Planning, which enables him to provide advice on all financial matters.

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