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## IN THIS ISSUE

“Markets regularly deliver surprises, some unexpected and others predicted. Trying to time the market and make sudden portfolio changes is a mistake many investors make.”

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# WHY US INFLATION SPOOKS INVESTORS

By Stefan Janse van Vuuren, Financial Planner at Brenthurst Wealth

For the past year, the impact of the Covid-19 pandemic dominated investment conversations, drove markets down and up again and was considered the biggest issue to consider when making investment decisions. US inflation has now overtaken Covid-19 as investors' biggest worry.

A Bank of America Survey conducted in March shows that the world's largest fund managers now think higher-than-expected inflation would be the biggest danger to the market, followed by a sharp bond sell-off. According to the report 37% of the 197 respondents – who manage \$597 billion between them – said higher inflation was the main threat that could damage markets. Meanwhile, 35% said a “tantrum” in the bond market was their chief concern.

This was sparked by the most recent meeting of the US Federal Reserve (Fed) Open Market Committee meeting where Fed chairman Jerome Powell emphatically squashed any rumors about looming interest rate hikes, pledged allegiance to US unemployment and downplayed fears about rising inflation as the committee kept interest rates at 0 – 0.25% for the foreseeable future.

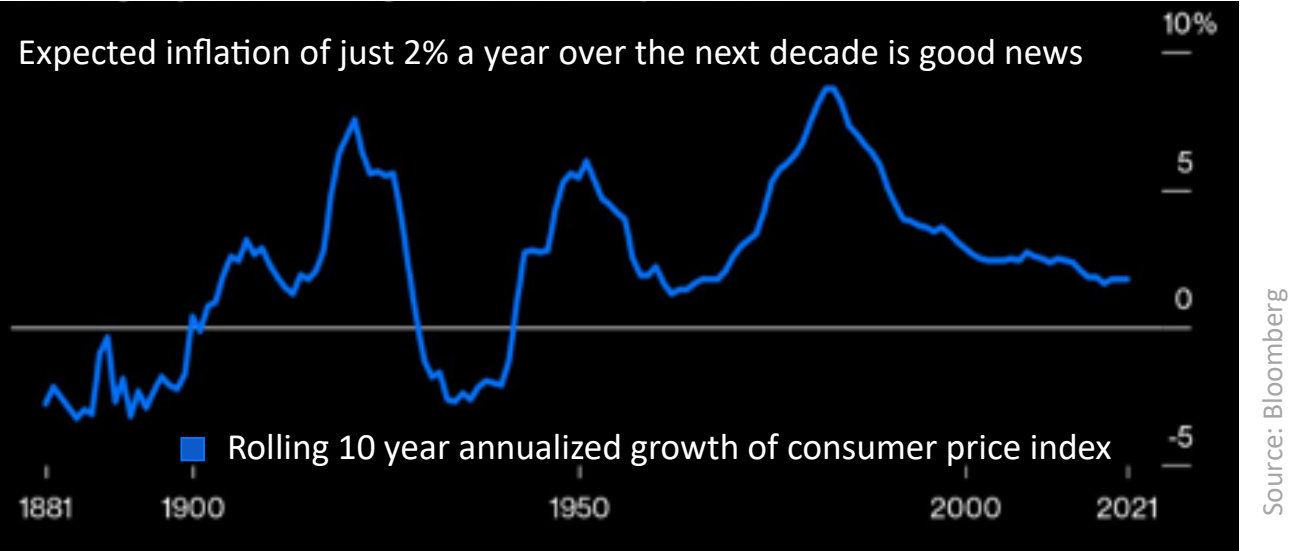
## WHY WORRY ABOUT INFLATION?

As stated by Morgan Housel, acclaimed finance writer and author, in a recent article “Inflation happens when too much money chases too few goods, and Covid-19 closed a lot of businesses and gave people an unprecedented amount of money”.

0% interest rates and trillions of dollars in stimulus meant investors had free reign to allocate capital towards riskier assets such as growth stocks and cryptocurrencies, without having the safe alternative of investing in cash & bonds for a guaranteed, but supposedly lower return.

An increase in interest rates to halt inflation would have meant the re-emergence of a trade-off between risk and return, ultimately increasing the opportunity cost of holding risky assets (borrowing at 2% leaves more to ponder than borrowing at 0%).

**FIGURE 1: INFLATION IS WELL BELOW THE TARGETED 2% AND AVERAGE OF 2.2% SINCE 1881.**



Therefore, instead of investors celebrating the economic recovery, fears of an uptick in inflation and subsequent higher interest rates causing a stock market sell off have dominated the news. A possible explanation for investors nerves could be the tension in the market, caused by the speed at which the market not only recovered but gained ground since March 2020. All whilst various economies and businesses are struggling to find their feet. The recovery was mainly driven by a concentrated group of stocks, mostly from the technology sector and currently sit at severely inflated price multiples. The slightest sign in inflation and interest rates might cause some investors to cash in their profits.

**FIGURE 2: INFLATION/INTEREST RATE FEARS COULD POSSIBLY EXPLAIN WHY THE GAP BETWEEN VALUE AND GROWTH STOCKS NARROWED FROM RECENT HIGHS.**



The Fed has a dual mandate – control inflation (target inflation of 2%) and have the economy running at full employment. After the recent meeting policy makers pledged allegiance to the latter, giving the economy every chance of recovery even if it means inflation rises above its target level of 2%. Investors are justifiably nervous, scouring the horizon for any signs of inflation that may lead to interest rate hikes. The Fed’s announcement last week effectively dealt with those fears for now, pledging to eliminate unemployment even at the cost of higher inflation.

**Inflation can have serious ramifications for the finance system and stock market, severely damaging the world economy, however, to quote Morgan Housel again “The biggest economic risk is what no one’s talking about, because if no one’s talking about no one’s prepared for it, and if no one’s prepared for it its damage will be amplified when it arrives”. As was the case in 2019Q4 and 2020Q1 when all market commentators were worried about the yield curve inverting in the US, an historic pre-cursor for a recession. The US economy did experience a recession in the end, caused by Covid-19 with little care given to the shape of the yield curve.**

Inflation is on everyone’s radar, including that of the Fed who will be sure to not make the same mistakes as in the 1970’s when inflation rose to double figures.

To heed Bloomberg columnist Nir Kaissar’s advice – “until then, the fear of inflation is a greater threat to investors than inflation itself”.

**At the risk of sounding cliché, until then the best advice for offshore investors is to stick to portfolios which are diversified across different sectors, industries, and geographies. Do not allow fear to stop you from being invested and staying invested.**

Markets regularly deliver surprises, some unexpected and others predicted. Trying to time the market and make sudden portfolio changes is a mistake many investors make. It is advisable to consult an accredited, qualified advisor to navigate the investment universe and devise a financial plan best suited to your personal circumstances. Read more about [investment planning](#).



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Ten years ago, Brenthurst Wealth took the bold and brave step of setting up its own globally managed fund for exclusive use of its clients. Not only has the fund survived and grown the investments of its clients handsomely, it also beat the performance of some of the better known brand names on the investments landscape.

Magnus Heystek, co-founder, director, and investment strategist of Brenthurst Wealth says setting up this fund was an important component of the company's strategy to increasingly focus investments on offshore markets. "As global markets started to recover from the so-called 'great depression' of 2007/2008 the risks to the South African economy and the long term outlook of muted to poor returns became evident, it was the perfect time to launch our own global fund."

READ MORE: [Brenthurst-Global-Balanced-fund-celebrates-10-years-Issue-389-April-2021](#)

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### ADVISORS PROFILE: STEFAN VAN VUUREN FINANCIAL PLANNER | BCom Hons Financial Analysis



STEFAN joined the Brenthurst Wealth team in November 2019 as a Junior Financial Advisor at the Stellenbosch office. He currently works under the direct supervision of Sonia Du Plessis, while also assisting all other financial advisors in Cape Town.

He has obtained his BCom degree in Investment Management and a BCom (Hons.) in Financial Analysis from Stellenbosch University.

He is also currently a CFA Level II candidate and will, in time, pursue his studies further in order to obtain his Postgraduate Diploma in Financial Planning.

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