mysuper

06. Inflation

Shining a light on inflation and its impact on cash and fixed income, and my**super**.

Welcome to an insider's guide to investing with my**super**. As a member, it's worth knowing the ins and outs of how your money is working for you. Not that you have to do anything, but to achieve your goals it helps to understand how your investment lives and breathes.

Guide 06.
Explains the impact of inflation.

Here we shine a light on how the rising of prices decreases the value of money, what this means for cash and income assets, and how to protect against it.

What is inflation?

Inflation is when the price of goods and services goes up, and the value of your money goes down. Inflation can happen when there are increases in production cost, such as raw materials and wages. It can also go up when there is a surge in demand for products and services as people are willing to pay more.

How does inflation impact my**super**?

Inflation impacts low-risk income assets such as cash and fixed income. my**super** is a mix of these alongside higher risk growth assets (shares and property). Depending on the allocation of these in your fund by your fund manager, will determine how much inflation will affect it.

How does inflation impact cash and fixed income?

While a key advantage of income assets such as cash and fixed income is known cash flows (interest payments, return of capital), the major disadvantage is the erosion of capital over time due to inflation. So, whilst you get a steady income, the value may go down.

The impact inflation can have on the spending power of money is often overlooked by investors, as it is not as immediately obvious as the potential impact of volatility on equity values (change in share prices). However, the impact of inflation on the value of savings can be devastating over time.

What’s an example of the impact of inflation?

Averaging 6.1% pa since 1967, inflation has eroded the purchasing power of $1,000 by a whopping 94.9%. To think of it another way, to buy the same amount of goods $1,000 would have bought in 1967, you would need $17,970 today.

Similarly, the spending power of $1,000 invested entirely in bank deposits would also have failed to keep pace with inflation over this period.

How can you protect from inflation?

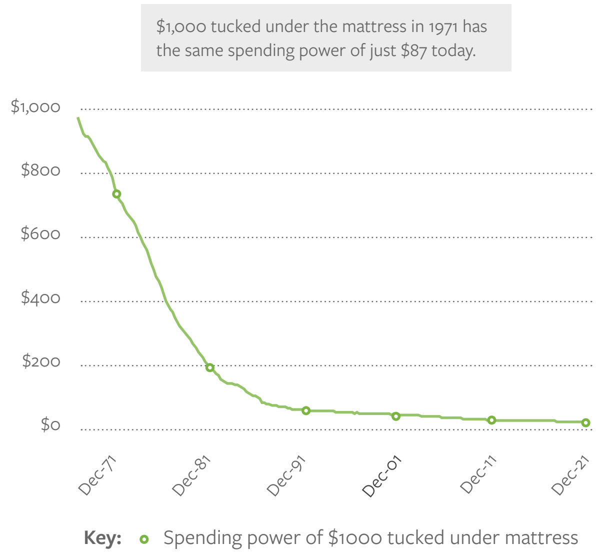
Inflation will always impact cash and fixed income. However, equities (shares) have been the only asset class that has not only protected the spending power of an investor’s capital over time but has also provided growth in income and accumulation of wealth after inflation.

Having a mix of investments that includes shares (such as several of my**super**’s funds), will protect you from the impacts of inflation on cash and income.

Rising your company’s prices of goods and services, and property’s rents, can also protect from inflation. To ensure that you can increase the income from your investments you need to invest in high quality property and shares of companies that have good ‘pricing power’ (the ability to raise prices as inflation increases).

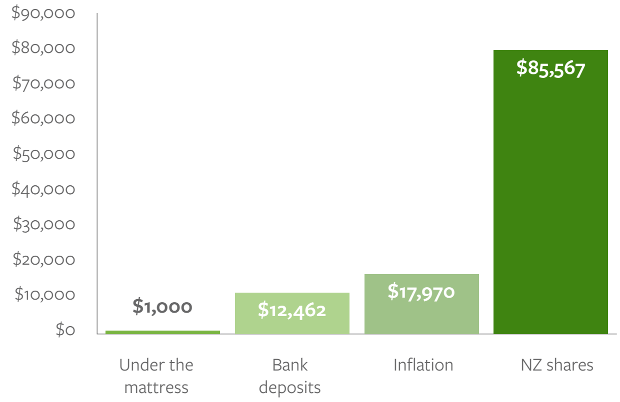
Sectors with good pricing power, and above average inflation protection, include core infrastructure (airports, toll roads and electricity) healthcare, food, property, and financial services (banks). Being able to protect your income in this way protects the value of the underlying assets against inflation.

The impact of inflation may not be immediately obvious but it consistently erodes the purchasing power of savings.



Own shares to help protect the spending power of capital from being eroded by inflation.

Rate of return since 1967 (%pa)	
Under the mattress	0.0%
Bank deposits	5.3%
NZ shares	9.5%



Source: Reserve Bank of New Zealand, Bloomberg. Share returns are calculated using the Barclays Capital Index form prior to 1986 and the NZSE Gross Index from 1986 to current. This index excluded dividends up to 1986, included gross dividends from 1987 to 2000 and net dividends since then – on balance it includes dividends reinvested net of tax. The six-month term deposit rate was sourced from the RBNZ, tax has been deducted from interest at a rate of 30% and interest has been compounded. Inflation has been calculated using CPI data.

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ITS-07-22