HSBC
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Video transcript

Ask Our UK Chief Investment Officer: Inflation and portfolio protection

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I want to talk about inflation and how you can protect your portfolio. Now, since the financial crisis, really, inflation wasn't too much of a concern; it was actually more about low inflation. And this is partly because of the structural headwinds of high debt levels, automation, and demographics. But actually, since the pandemic, we've seen inflation really surge and this is on the back of higher energy costs, also, supply chain shortages and a mismatch between jobs and workers as the economy's rebalanced.

Now, really, what is a concern to central bankers will be the expectations that me and you and companies have about inflation. And if these become unanchored, then there could be a wage price spiral as both wages and prices kind of bid each other higher. So, central banks want to get ahead of that and, actually make sure those expectations are tempered. And, by doing that, they will raise rates.

In an environment of higher policy rates, what does this mean for your portfolio? Well, first, it’s important to note that we think inflation will come down and we're confident about that. And particularly over the longer term, you'll still have these structural factors weighing on inflation. So, this is more of a case of rates rising up in the short term.

How would this affect your portfolio? Well, bonds can obviously weaken in this because they have that inverse relationship between yields and the price. But generally, as this is happening in the face of a robust global economy, then actually if you take more credit risk, then actually you’ll generally get rewarded for that.

Also, equities have the advantage of really being tied to earnings. And if companies can pass on those costs, then you've got a certain amount of protection there, particularly if you're going for what's called a high-quality company where they have high margins, strong pricing power, they can really kind of protect themselves against these higher input costs.

And then it's going to be a volatile environment. It's very uncertain, it's very hard to predict with certainty where rates are going. So, some of these expectations are baked in but this can change. And during this uncertainty it means volatility will remain elevated and there's certain asset classes that can take advantage of that. And, really, hedge funds are very good at that because they have a very flexible approach and can really take advantage of swings and different kind of performances across asset classes.

But overall the main thing is to really make sure that you've got a diversified portfolio, because a diversified portfolio will help you protect against inflation over the longer term. Also, look at asset classes that can help with your diversification and also help perhaps in environment where it's more volatile, take advantage of that volatility.

And, of course, if you have any questions on this, please speak to us and then we can help you further.