FINANCIAL INVESTMENTS





What does inflation mean for me as an investor?

You should take inflation into account in your investment strategy.

Inflation reduces real returns on financial investments and erodes your purchasing power.

Inflation and rise in interest rates can have different effects on different kinds of financial instruments:

For example: Financial instrument X has nominal returns of 3% before inflation. If inflation is 5%: the real return is negative (-2%) and the purchasing power of the invested capital falls by 2%

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SHARES

The impact of inflation and the rise of interest rates on the stock market is not straightforward.

The general increase in the prices of goods and services may impact firms' profits, thus affecting the price of their shares on the market positively or negatively. For retail investors this is not easily predictable, as inflation will not impact the share prices of all firms in the same way.



FINANCIAL INSTRUMENTS WITH FIXED COUPON RATES

You may have financial instruments with fixed coupon rates. Many government or corporate bonds take this form. You will receive:

- a periodic fixed payment until the date the instrument reaches its maturity (coupon); and
- the repayment of the initial investment (nominal value) at maturity.

Inflation has an impact on these investments. At maturity, the amount received will be the same during inflationary cycles, but the purchasing power of this amount is reduced. In other words, the same amount will buy you less in times of inflation.

For example: Let's say that a threeyear bond pays EUR 1000 every year. Inflation means that, in the third year, EUR 1000 will buy less than in the first and second year.



FINANCIAL INSTRUMENTS WITH FLOATING COUPON RATES

You may have financial instruments with floating coupon rates such as variable-rate bonds. You will receive:

- a periodic variable payment until the date the instrument reaches its maturity (coupon); and
- the repayment of the initial investment (nominal value) at maturity

The value of the periodic coupon is variable, depending on various factors (for example, it could be linked to interest rates, inflation, etc.).

Inflation has an impact on the repayment received at maturity, which will be the same during inflationary cycles, but the purchasing power of this amount is reduced. The periodic coupon will vary and might be able to counterbalance the effect (or a part) of inflation. However, it is not always the case that coupon rate changes will reflect the current level of interest rates, nor that they will compensate the rate of inflation.



INVESTMENT FUNDS

Investing in investment funds gives access to a portfolio composed by several financial instruments. The impact of inflation and the rise of interest rates on investment funds depends on the type of fund and the composition of its investment portfolio: types of asset classes, activity sector, etc.



3 steps you can take to deal with the impact of inflation and rising interest rates on your financial investments



Pay attention to the real return of your financial investments

When comparing investment opportunities or analysing potential risks and benefits of a financial instrument:

- always consider inflation risk and the possible effect it may have on the real value and real return
 of the investment
- keep in mind that inflation risk comes in addition to the normal costs of investing in financial products such as: entry and exit fees and transaction costs, etc. Compare the costs of your financial investments and check if there are cheaper alternatives available

Check or ask your financial advisor for information on costs and on net real returns (after total costs + inflation).



Consider diversifying your investments

Always keep in mind the core tenets of investing:

- maintaining a well-diversified portfolio
- ensuring investments remain aligned with your goals

Diversifying the types of instruments invested in a portfolio might generate a high-enough return to counterbalance the impact of inflation.

Balanced portfolios including investment funds, shares and bonds may help hedge against inflation risk:

- Shares are subject to higher risks and variability compared to bonds, yet they typically provide higher expected returns, and the inflation effects are not clear cut as previously explained
- Bonds may be more directly impacted by inflation and subsequent increases in interest rates, yet their price is less volatile than the price of shares
- Investing in investment funds, such as Undertakings for Collective Investment in Transferable Securities (UCITS)), might help diversifying your portfolio. These instruments not only eliminate the need to select individual shares or bonds, but also offer exposure to different major asset classes and economic sectors, depending on the composition of their investment portfolio



Seek advice to adapt your investments

A financial advisor can help you make more informed decisions.

As an investor, if you have doubts on how inflation may impact your financial investment, discuss with an authorised financial advisor. During inflationary periods, you might contact a financial advisor who will evaluate the need to update your profile and reassess the suitability of your investments.