Deploying cash in an inflationary, rate-rising environment

By *Jonathan Unwin*, deputy head of asset management and advisory at Banque Havilland

2022 PERHAPS PRESENTS the most challenging environment for savers and investors in over a decade as triumverate of soaring inflation, low interest rates and volatile capital markets mean there is no easy way to allocate liquid wealth.

With official inflation in the UK having already risen to 5.5% (consistently reading higher than economists' expectations) and the highest available bank saving rate currently around 0.75%, then clearly any cash deposit will see its value seriously diminish over time in terms of purchasing power. Unfortunately, even cash, with its guaranteed decline in real value, remains more appealing than the bond market due to the fixed nature of the asset-classes income stream against a backdrop of central bank rate rises in response to post-pandemic inflation.

With bond yields starting to rise in earnest, following decades of compression the potential for deeply negative total returns for a basket of sterling bonds is great, as central bank support is switched of and the Bank of England raises base rates. The spike in bond yields, consequentially, is also rendering a passive allocation to the stock market as an inadvisable idea.

In recent years a generic holding in a market-tracking index fund has been a good strategy: inexpensive, quick and easy to invest, requiring minimal subsequent attention, and importantly double-digit returns (for a standard 'world' ETF). As we know, the main drivers of these returns have increasingly been provided by the 'mega-tech' growth stocks, some of which are already hugely profitable businesses and some of which are 'the stocks of tomorrow' but yet to break even.

What both sets of stocks have in common is the promise of high future cash flows, with an accompanying expensive valuation. As higher bond yields set in, the relative appeal of these cash flows diminishes the further into the future they are – hence the aggressive selling we have seen in recent months of these long-term growth equities. Simply put, a passive, global index tracker will cease to be the 'no-brainer' investment it has been, and a more nuanced, selective approach is required.

Property, long the preferred choice for British investors, will also be affected by rising inflation as the Bank of England is compelled to raise interest rates. While the increasing cost of living may not directly concern high-net-worth individuals, for many it will mean saving for a deposit takes longer while mortgages themselves will become more expensive – with many unprepared for higher rates. This could have a bottom-up effect on the housing market, meaning prices may not keep up with inflation either.

At Banque Havilland, we always promote a liquid, multi-asset class portfolios to our clients as the most consistent means of preserving wealth over the long term, even in times of absent inflation, with truly bespoke portfolios available from £5million. An equity-dominated allocation remains the best way to ride out the current environment, with a selective global approach that is able to fully avoid the frothy parts of the market.

For example a focus on banking and mining stocks that can actively benefit from higher interest rates and commodity prices respectively points to the UK market, while domestic Japanese stocks are not facing the inflationary challenges of other developed economies.

Alongside a highly selective equity allocation, we have expertise in identifying uncorrelated funds and strategies that offset normal market risk, including precious metals, commodities and non-directional vehicles. Our portfolios are positioned for the long term but can be liquidated on a daily basis, and this combined with the fast decision-making ability that comes with being a stripped-back, boutique bank, enables a very agile investment process, should the backdrop change.

A nimble and high-conviction approach to markets, within a traditional portfolio structure that actively seeks to exclude the most vulnerable assets, is the best way to deploy cash in an inflationary, rising rate world.

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