OUR TWO CENTS

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MICHAEL CAROLINE

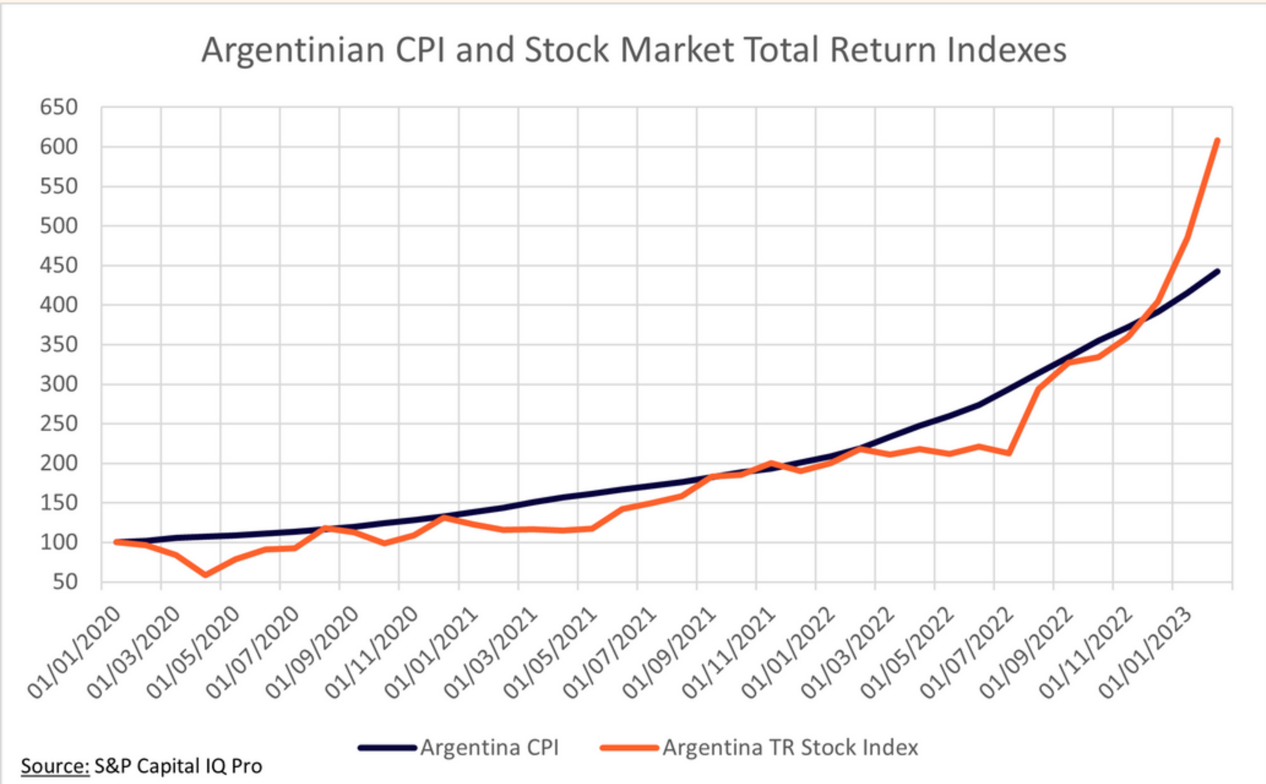
BCom (Hons) Investment Management (UP) | MPhil in Finance (UP) | Passed CFA Level 3

Michael joined as an investment analyst and has an MPhil (Financial Management Sciences) cum laude specialising in economic psychology and has passed the CFA level 2 exam. Prior to starting at New Road Capital, he worked as assistant lecturer at the University of Pretoria assisting with quantitative investment analysis. He has built and traded on models using CFDs. Outside of work, he enjoys flying motor gliders from Springs airfield as well as sailing his Laser class sailboat.

Inflation, Emotions and Stocks

Persistently high inflation has been a concern in many countries for the past year with a lot of fear being felt by investors regarding what will happen. During this time, every asset class has subjected investors to volatility and tested their resolve. It is important for investors to remember that withstanding volatility is simply a price to be paid for long term rewards.

For example, consider the inflation rate and stock market performance of Argentina. The most recent inflation print was 114.20% beating the previous month's figure of 108.80%! The total return of the stock market; however, didn't get left behind for long. Since a stock represents a share in a company and is linked to the financial performance of the company, and since companies can pass on inflation to customers, the real value of the stock market is generally able to move in line with inflation. In addition to this, a country with a high inflation rate will experience a currency depreciation relative to countries with lower inflation rates. This means that any foreign company stocks will appreciate to compensate for the exchange rate movement. The protection offered by stocks comes at the price of higher volatility and requires time to materialise. Over this period, an equity investor would have had to endure an extremely high level of volatility as well as the economic news flow. This is illustrated in the following graph which compares the performance of the Argentinian stock market total return and the CPI level rebased to 100 at the beginning of 2020.



Although the Argentinian stock market initially fell behind, it caught up with and overtook the inflation rate leaving any investors who simply held on to their position better off with a return well above inflation. Additionally, the investor would have been rewarded with a return of 22.98% p.a. in US Dollar terms! Stocks may be volatile in the short term and many investors are tempted to trying market timing strategies but ultimately, patience and resisting the urge to react to short term volatility is key to reaping long term rewards such as the inflation protection property of stocks.