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Six ways to beat inflation and protect your investments

Rahul Oberoi October 29, 2013

A penny saved is a penny earned. But thanks to inflation, over time, the **value of the penny saved** could be much less than when it was earned. One cannot ignore the corrosive impact of rising prices on investments.

For instance, a Rs 100 earned will be worth just Rs 92 after a year if it is not invested and the inflation rate is 8%. That is why one always has to be on the lookout for investments whose returns are more than the prevailing inflation rate.

"When **looking at investments,** always focus on what is the real return or the return net of inflation," says Raghavendra Nath, managing director, Ladderup Wealth Management.

PH Ravikumar, managing director, Capri Global Capital, says, "Inflation erodes savings of citizens and hence capital formation is so important for growth of a developing economy like ours."

In September, the annual consumer price inflation jumped to 9.84% from 9.52% in August. However, the headline inflation, as measured by the wholesale price index, rose 6.46%, the highest in the past seven months, due to higher food prices.

Let's look at some ways to stay ahead of inflation.

INVEST IN EQUITIES/EQUITY MUTUAL FUND:

Investing in equities over a long period is one of the best ways to stay ahead of inflation. Over the last 10 years, the Nifty has returned 16.7% a year compared to the 7% average inflation rate. One can either invest directly or through mutual funds. For small investors, it is advisable to invest through mutual funds, as they are managed by experts.

Anil Rego, chief executive officer, Right Horizons, says investors should look at diversified equity mutual fund schemes to earn higher risk-adjusted returns. However, equity investments should have a horizon of at least three years, sometimes even longer.

Another way of lowering the overall risk is investing via systematic investment plans or

SIPs. The compounding impact of such investments over long periods will help you beat inflation by a comfortable margin.

INVEST IN DIVIDEND-PAYING STOCKS:

One good way of staying ahead of inflation is buying stocks that pay good dividends. Interest rate offered by banks is usually much less than the inflation rate.

{quote}"Dividends are a tangible return paid by companies and keep up with inflation," says Raghu Kumar, cofounder, RKSV, an online share trading company.

Just like inflation, dividends, too, can be calculated annually. This figure, called the dividend yield, can be measured by adding dividends received during the year and dividing it by the stock price. The yield must be higher than the annual inflation rate.

ASSETS LIKE GOLD AND REAL ESTATE:

Gold is considered an ideal hedge against inflation. Market experts say real estate can also be an option if one can afford to spend a big sum. However, only a small part of your portfolio should be **allocated to these options.**

DIVERSIFY GEOGRAPHICALLY:

Asset allocation is critical. In this, one can look at an opportunity is to diversify globally. This will make your portfolio more stable and less vulnerable to domestic volatility and inflation.

INFLATION-INDEXED BONDS:

These bonds are a great way to beat inflation as they are designed to protect both principal and interest.

The basic mechanism of an IIB is quite easy to understand. Assume that the annual coupon, that is, the amount the investor receives at the end of the year on his bond investment, is 7%, and he has invested Rs 1,000 (his principal); in this case, he originally would have been paid Rs 70 at the end of the year. However, assume that the inflation index for the year is 10%. Through an IIB, the 7% coupon is then applied to the new principal of Rs 1,100 (10% of Rs 1,000 + Rs 1,000), which comes to Rs 77 plus Rs 100 increment on the principal. Thus, the investor is sure to generate a return higher than the inflation rate.

"The principal is indexed to inflation and, hence, IIBs safeguard principal from inflation," says Rego.

Vikas Gupta, executive vice-president, ArthVeda Fund Management, says, "Inflation index bonds are widely available securities in the developed markets that offer inflation protection to retail customers."

RE-ALIGN YOUR PORTFOLIO:

Kapil Narang, chief operating officer, Ameriprise India Advisory Services, says during periods of volatility and high inflation, it is imperative for an investor to **reassess his/her asset allocation** taking into consideration risk, times horizon and goals. At the same time, it is equally important for an investor to take a long-term view so that his reaction to developments in the market is not knee-jerk.

For example, if one were to look at the Sensex from 2009 onwards, one might be shocked to find that the index has actually has gone up almost 110% during that time (an annualised rate of almost 17%).

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