

Effect of Inflation on Investment  
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Think back to the summer of 2007, these were the days when cash savings interest rates were running at around 6% with average inflation over the year at 2.3%. This gave a healthy real rate of return of around 3.7%. These conditions were perfect for the cautious investor.

Unfortunately, times have changed and it is becoming increasingly difficult for the cautious investor to see any real rate of return using this type of savings vehicle. It has just been announced that inflation has hit its highest rate since November 2008 at 3.7% (Consumer Prices Index). If cash savings rates were still that of 2007 this wouldn't be too much of an issue but with the Monetary Policy Committee keeping the base rate at 0.5% banks have been unable to offer more than 3-3.5% meaning that investors are facing capital erosion i.e. losing money in real terms.

Today, cautious investors increasingly have to use other vehicles in order to keep pace with inflation to ensure that their capital retains its value. Longer term saving bonds are currently offering rates of around 5% over 3 to 5 years. In the short term, this provides a solution, however if interest rates increase within this fixed period, the investor is locked in and will be unable to take advantage of any future increases.

For those who do not require access to the money in the short-term, an alternative would be to use an asset-backed investment such as a stocks & shares ISA. This type of investment can be matched to any investor's attitude to risk. This can range from cautious to very high risk. In the long term, historical data shows that asset backed investment will often outperform cash.

For help and advice on choosing the most suitable investment products we would always recommend meeting with an Independent Financial Advisor.

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