Seed Weekly

4 September 2019

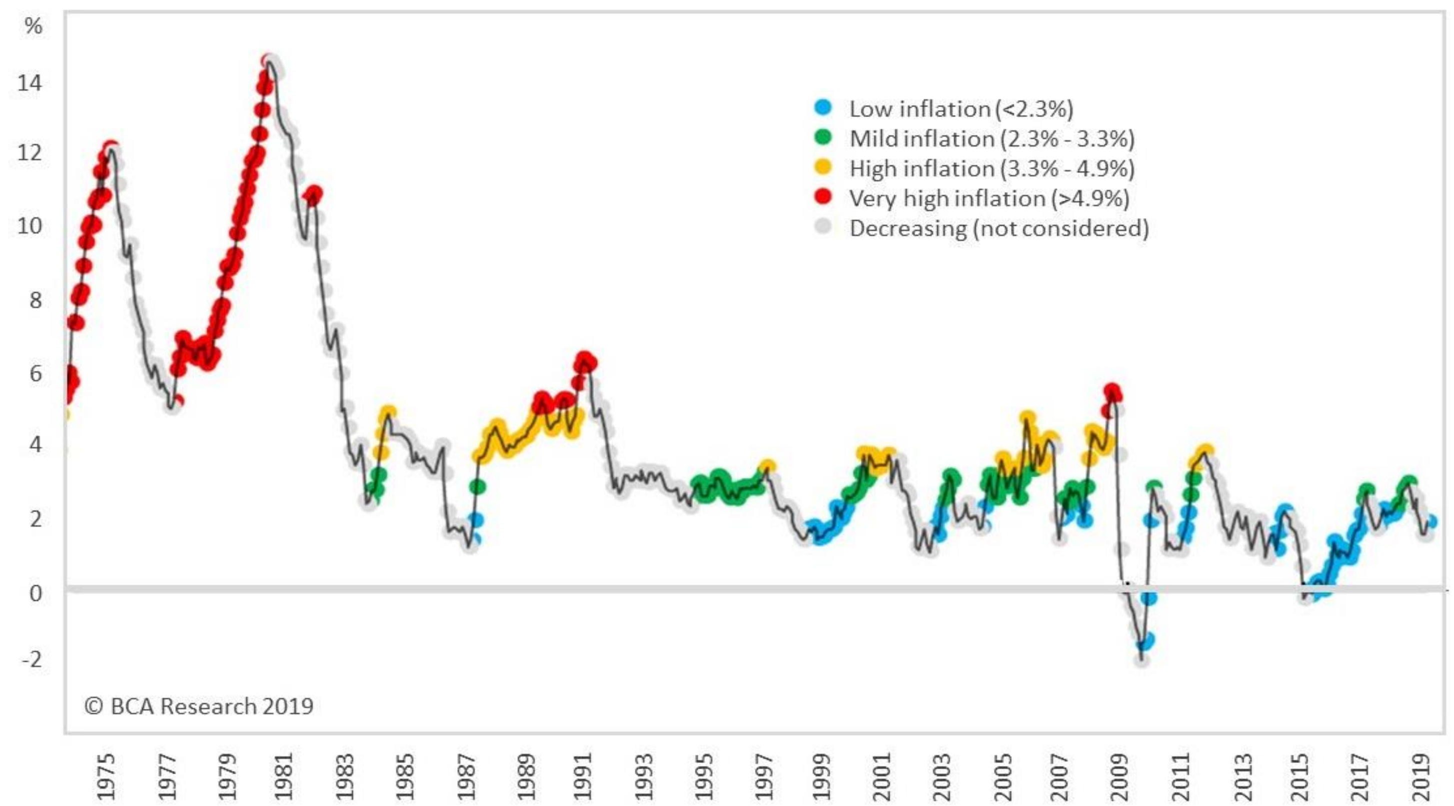
Global Asset Classes to Hedge Inflation

An important part of Seed's multi management process is to perform monthly asset class valuations using our in-house quantitative models. This process covers all the local and global asset classes that are suitable for inclusion in our multi asset class funds and model portfolios. The output of these models guides our tactical asset allocation decisions, where we under- or overweight certain asset classes in the short term, compared to our longer-term target weights.

In times of excessive market volatility, geopolitical uncertainty or high inflation, we will look to certain asset classes to hedge the increased risks. In a recent article entitled Gold by Ian de Lange, we looked at gold's supply and demand dynamics and its ability to maintain its purchasing power over centuries.

BCA, a research house that Seed makes use of on the global side, recently highlighted the performance of various asset types in rising inflation environments in order to identify further effective hedges. But why is this relevant now?

BCA's view is that inflation in the US, although moderate at the moment, is in a structural uptrend. The main reasons are accommodative monetary policy (lower rates), expansionary fiscal policy (lower taxes) and the view that globalisation has peaked. **Chart 1** (below) illustrates the various rising inflation environments in the US since 1975, noting that inflation has been very low since 2015.



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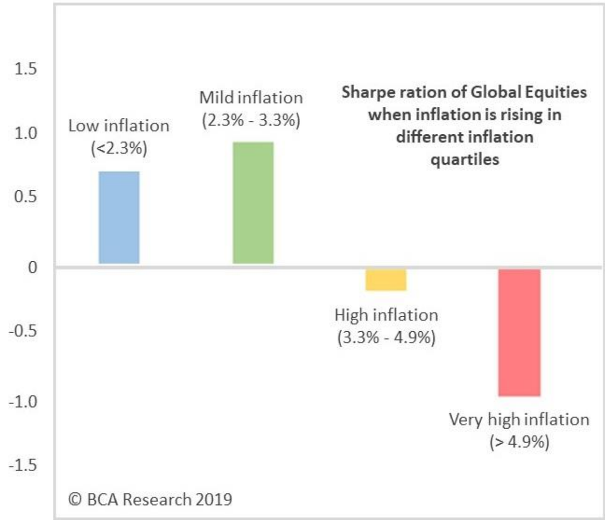
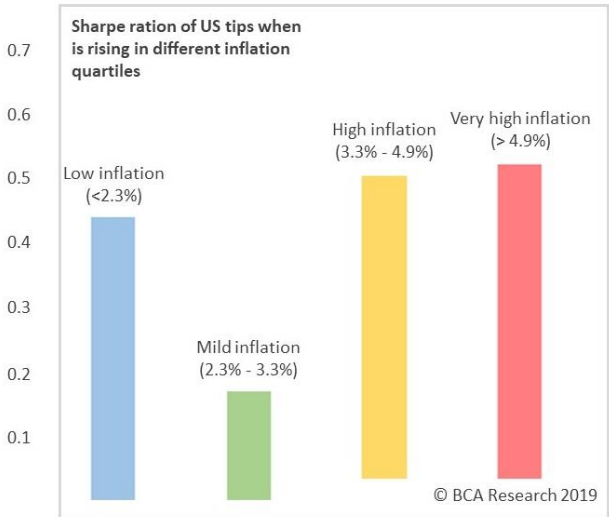
Equities : Not A Great Hedge

Equities generally perform well when inflation rises but is still low to mild. This environment usually means low interest rates and a growing economy, which enable companies to grow their earnings as well. However, when inflation increases further, growth expectations decline. Investors then value shares at lower multiples and asset prices drop. In a high inflation environment, Energy and Materials should outperform, while defensive sectors such as Utilities and Healthcare hold up best when inflation is very high.



US Inflation-Protected Bonds : Delivers as Promised in All Rising Inflation Environments

US TIPS are essentially US Treasury Bonds that are indexed to inflation, meaning the principal value rises or falls in line with inflation. This product was specifically designed to protect bond investors from rising inflation and is very effective in a high to very high inflation environment.



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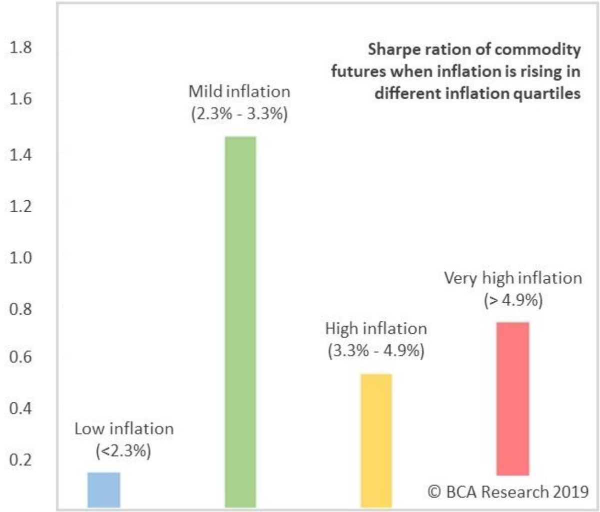
Commodity Futures : Gold and Silver Shines When Inflation Blows Out

Commodities do well when inflation is either mild or very high. Energy and Industrial Metals outperform when inflation is mild, as the economy is strong and demand is high. However, when inflation peaks, investors flee to the safety of precious metals. Gold and Silver have delivered 15% - 20% excess returns compared to cash during periods of very high inflation.



With US inflation currently at a low 1.8% we are some way off from taking active measures to specifically hedge against inflation. However, with the Fed expected to cut rates 2 or 3 more times this year, and the US labour market still tight, inflation risks are definitely to the upside. At the moment, a greater concern in the management of the Seed Global Fund is the trade war's influence on sentiment, which may lead to a sustained risk-off environment and asset flows out of equity markets into more defensive asset classes.

Kind regards,

Cor van Deventer *CFA, FASSA*
Portfolio Manager

Chart source(s) : BCA Research (31 August 2019)

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DISCLAIMER

GLOSSARY OF TERMS

Annualised Return — Annualised return shows longer term performance rescaled to a 1 year period. Annualised return is the average return per year over the period. Actual annual figures are available to the investor on request.

Annualised Volatility — The deviation of the calendar month return stream, since launch, relative to its own average.

Highest and Lowest Annual Return — The highest and lowest returns, since launch, for any rolling 1 year period have been shown.

Maximum Drawdown — The maximum calendar month peak to trough loss, since launch, suffered by the Fund.

NAV — The net asset value (NAV) represents the assets of a Fund less its liabilities.

Positive Months — The percentage of calendar months, since launch, where the Fund has delivered a positive return.

Return Horizon — Minimum investment period to have a reasonable probability of receiving the benchmark return.

Risk Horizon — Minimum investment period to have a reasonable probability of receiving a positive nominal return.

Total Expense Ratio (TER) — The Fund's Total Expense Ratio (TER) reflects the percentage of the average NAV of the Fund that was incurred as charges, levies and fees related to the management of the Fund. A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs.