Should You Buy More Equities To Counteract Inflation?
By: Joe the Investor

When you decide on an asset mix for your portfolio, you typically choose the asset mix based on return, risk, comfort with market volatility, income needs, time horizon and some individual factors like taxes, knowledge of certain sectors, concentration in your portfolio of real estate to name a few factors. This asset mix assumes a rate of return on equites and fixed income.

What happens if inflation starts running high? You first have to believe that inflation will be sustained over many years. If it is not, the asset mix should not be changed. If inflation is expected to last for years, observe the following effects: Cash will lose its value via its purchasing power over time. Fixed income will also lose value as the rates of return are abysmal and will not keep up with inflation. Equities will have higher dividend yields and should see increasing prices if inflation persists, especially if the equities contain physical holdings. Physical items hold their value the best with high inflation if they are items that are in demand – commodities, food, real estate and means of production.

Examine the dividend yield in your equity portfolio. Is it higher than the rate of inflation? It would be helpful to know what your personal rate of inflation is – what are you spending your money on and how much these items are increasing in price. This may vary widely from the CPI or government statistics, mostly because you may not spend like the average person. If health care and education costs are going up faster than the average and you are not spending money in these areas, your rate of inflation is lower than the published average as an example. If your dividend yield exceeds inflation, you may not want to change your portfolio because you are able to preserve your wealth.

Does this mean that if inflation runs high that I should have more equities in my portfolio? The trade-off you are making is between the risk of having too high of an equity exposure and having a market correction which creates a panic scenario, and not having enough equities but inflation persists which erodes the value of your portfolio. The original asset mix was chosen to avoid the risk of having too great a loss from a market correction. Has this perception changed if inflation persists? Would you be able to ride out the situation knowing that you may counteract the erosion from inflation?

Other options to dealing with inflation might be having a rental property and raising your rent, or indexing of inflation in a pension plan or other fixed income, or holding hard assets like precious metals and real estate which would have gains even though your equities and fixed income may lose money due to higher inflation. There is also an option of reducing your reliance on currencies by producing more of the goods that you consume. This looks like living in a trailer park or a cottage, having a hobby farm, doing more gardening, or having multiple side hustles producing physical goods. This option will require a major lifestyle change, but it can be effective if you have access to means of production.

Purchasing more equities to counteract inflation may work in some scenarios, but the underlying reasons should be examined before making this decision. There may be other options to dealing with inflation.