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FONDI SICAV

Inflation set to remain low in near future

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In recent times there has been talk of faint signals of a resumption of inflation. What's the scenario for the coming months? Here's the input from Francesco Castelli, head of Fixed Income at Banor Capital Ltd, to Fondi Sicav's investigation.

- Inflation in the industrialised countries seems like a sleeping giant. However, several commentators are beginning to speak of an end to the deflationary cycle we've experienced since the start of the post-Lehman crisis. What's your view on that?

We don't see an immediate risk of a new rise in inflation. The forces driving the developed countries into deflation are, unfortunately, a structural, not transitory, phenomenon. Technological innovation and e-commerce (led by giants like Amazon) are creating enormous competition in distribution. To this must be added a generally sluggish economy, as a result of demographic factors (which are not helping inflationary trends in consumption) and the "long wave" of the great financial crisis of 2008. Lastly, commodities have partially stabilised but we don't think, in the short term, that they're liable to trigger an inflationary panic. Only in the USA are we seeing modest symptoms of rising prices, underpinned by wage trends and the boom in profit margins.

That said, the trends in the financial markets don't depend only on current inflation (which, we repeat, is set to stay low in the near future). Shares and bonds are also very sensitive to inflation expectations. Until now, monetary policy alone, even when it's very "creative", hasn't proved very effective against deflation. The situation could change if fiscal policy returned to a more expansionary stance, especially in countries (like Germany) that can afford some additional public spending.

- In the event of a return to rising prices, which asset classes would you recommend for investors to defend themselves from inflation and obtain positive real returns?

The investments most at risk in an inflationary scenario are clearly government bonds. The negative returns on German 10-year bonds would work well only for people who believe in a decade of deep depression. Being more optimistic, we recommend that investors should go very light on government bonds and replace them with a combination of liquidity and corporate and high-yield bonds. The only place where we see the risk of a (moderate) rise in interest rates and inflation is the USA. In this case, the best way to protect your capital is to choose the right shares and sectors. That’s why our Banor SICAV – North America fund has taken on a very significant exposure to US banks (which will benefit from the rising rates) and gone light on consumption sectors, which will see a contraction in margins and multiples.