MILANO FINANZA

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In Gestione

DILEMMA INFLAZIONE

***Bonds:** is the cost-of-living crisis easing? How to invest in indexed funds*

THE INFLATION DILEMMA

by **Marco Capponi**

Which direction is inflation really heading? Mixed messages continue. In the US in February it rose on an annual basis by 6% from 6.4% in the previous month and on a monthly basis by 0.4%. This is the most modest increase since September 2021. Everything is relative, of course: the increase in consumer prices in the US is still at levels that were completely unimaginable at the start of 2022, when the central banks still forcibly held interest rates at zero. But something is changing: on 22 March, the FED raised the cost of money by "just" (so to speak) 25 base points and, also on the basis of banking turmoil, governor **Jerome Powell** announced that the squeeze was coming to an end.

In the meantime, inflation in the Eurozone in March showed a marked slowing: 6.9% compared to the 8.5% in February. Economists expected a less significant reduction, around 7.3%. In its last meeting, the ECB raised interest rates by 50 basis points, and the President, **Christine Lagarde**, confirmed that the priority of the institute was to combat the cost-of-living crisis with aggressive monetary policy. But also on the basis of new data, there is hope of some softening of the situation, also considering the current banking crisis.

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Considering all of these factors, it is still difficult to identify a general rule regarding how inflation will evolve in coming months. In this context, investors seek even greater guarantees, particularly if, with the current banking crisis, central banks decide to set aside efforts to combat inflation in order to preserve credit stability. This is demonstrated by the success of the new BTP Italia issue with maturity in March 2028 and minimum annual real coupon guaranteed at 2% before tax, in addition to the ISTAT inflation rate, which received retail orders over € 8.5 billion, eclipsing the € 7.3 of the previous issue back in November 2022. In addition to individual bonds, another way to hedge savings from inflation using asset-management solutions is to invest in inflation-linked bond funds. The **Fida** table below gathers 10 products of this type, ranked by 2023 performance: with the average yield in January at 2.5% (with points above 3%), which rose from -7% annually (far less than the overall collapse seen in bond markets) an returned to a positive three-year figure of +6.6%. There are obviously warnings, as highlighted by **Francesco Caselli**, head of credit strategy and fund manager for Banor "Investors approaching these securities today should consider that the coupon level expected for 2023 will be significantly lower than that seen last year." Considering the possible easing of inflation pressure "the expected yield on inflation-linked bonds risks being very similar to that of equivalent fixed-rate securities", the asset manager explains.

Axa Funds Management, with the Euro Inflation Bonds strategy (+2.6% in 2023, +8.9% over three-year), came it at second place in the Fida ranking. **Jonathan Baltora**, the fund manager, believes that the current context "is interesting for inflation-linked bonds, as central banks could be forced to suspend interest-rate hikes before the inflation situation stabilises, transforming inflation into a potential problem for the coming decade". In terms of composing the portfolio, with the current situation the money manager prefers "more liquid markets, such as the US, UK and Euro area, with broad diversification, focusing on the five-year inflation-linked segment".

Eurizon, a **company** of the **Intesa Sanpaolo** group, approaches this asset class with its Bond Inflation Linked fund (+2.5% in 2023). According to the management team, inflation-linked funds are still a good option for diversification, even if the high cost of living has peaked. "The macro context will be characterised by different inflation dynamics compared to the phase prior to the pandemic: the energy transition, redefinition of production chains, geopolitical factors and changes in the labour market will lead to inflation being higher than expected on average". Regarding duration, money managers are focusing on "intermediate durations, rather than shorter-term options, which are impacted by the volatility of monthly data".

A SELECTION OF INFLATION-LINKED BOND FUNDS BY 2023 YIELD

Name	*Currency*	*Company name*	*Fida category*	*Current-year yield*	*1-Year yield*	*3-Year yield*
HSBC GIF Global Inflation Linked Bond A	USD	**Hsbc Invest. Funds**	Global inflation-linked bonds	**3.16%**	-3.68%	7.14%
AXA WF Euro Inflation Bonds A	Euro	**Axa Funds Management**	Euro Area Inflation-Linked Bonds	**2.60%**	-7.92%	8.89%
FAM Series Euro Infl. Linked Govt Bd L	Euro	**Fineco Am**	Euro Area Inflation-Linked Bonds	**2.58%**	-7.67%	-
EF Bond Inflation Linked R	Euro	**Eurizon Capital**	Euro Area Inflation-Linked Bonds	**2.52%**	-8.49%	6.12%
Fidelity Global Infl. Linked Bond Y	USD	**Fil Inv. Management**	Global inflation-linked bonds	**2.50%**	-3.75%	10.13%
BNP Paribas Euro Infl-Linked Bond	Euro	**Bnp Paribas Am**	Euro Area Inflation-Linked Bonds	**2.44%**	-7.81%	6.55%
CS (Lux) Global Inflation Linked Bond B	USD	**Credit Suisse Fm**	Global inflation-linked bonds	**2.40%**	-0.40%	13.04%
PIMCO Global Real Return E	USD	**Pimco Global Advisors**	Global inflation-linked bonds	**2.36%**	-9.48%	5.33%
MFS Meridian Inflation Adjusted Bond W1	USD	**Mfs Im**	Global inflation-linked bonds	**2.33%**	-4.90%	10.07%
GS III Global Infl. Linked Bond X	Euro	**Goldman Sachs Am**	Euro Hedged Global Inflation-Linked Bonds	**2.30%**	-16.52%	-7.79%

Performance based on data available at 21/03/2023 Retail classes - capitalisation of earnings *Source: Fida*