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# Investment Week

## Managers reveal inflation-busting tips as CPI soars

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Investors have come under increased pressure to inflation-proof their portfolios as a fresh spike in CPI and RPI raised doubts levels will drop back to the [Bank](#) of England's 2% target in 2012.

CPI inflation rose at an annualised rate of 5.2% in September, the joint highest level seen since the series began in 1997, while RPI inflation increased to its highest level in 20 years at 5.6%.

The BoE maintains inflation will pull back sharply in 2012, pointing to lower food and energy prices as well as this year's VAT hike falling out of the annualised figures early next year.

A deteriorating growth outlook makes it "more likely inflation would undershoot the 2% target in the medium term without further monetary stimulus", the Bank said at its latest meeting, when it announced an extra £75bn worth of quantitative easing.

But while the consensus is inflation is now peaking, many are questioning the Bank's forecast of a speedy decline, particularly as core inflation, which strips out food and energy costs, remains elevated at 3.3%.

"Economists as a group are remarkably willing to go along with King's forecast despite his awful record in recent years. Whether markets have completely bought in is difficult to say," said Henderson chief economist Simon Ward. He expects to see inflation bottom out at 2.5% next summer before moving higher into 2013.

John McNeill, head of international rates at Kames Capital, added: "In anything other than a complete meltdown in the eurozone, which would have a clear deflationary effect, the path to a lowering of inflation may not be as swift as the Bank has suggested."

[Investors](#) looking to protect against inflationary pressures have even struggled to find value in index-linked gilts over the summer as concerns over growth take precedence and drive down breakeven rates.

The difference between nominal and inflation-linked ten-year bond yields has fallen from 3.3% in April to about 2.6%.

M&G bond managers Richard Woolnough and Jim Leaviss have been adding to their index-linked gilt exposure in recent weeks in the £5.1bn M&G Corporate Bond [fund](#) and the £307m M&G UK Inflation Linked Corporate Bond fund in the belief breakeven rates are set to rise again.

Others, however, are less convinced. "Yields on index linkers are negative out to at least ten years, which is not a good starting point for an asset class," said Alan Wilde, head of fixed [income](#) and currency at Baring Asset Management.

Ian Williams, manager of the £88m Charteris Strategic Gilt fund, said investors should look elsewhere for inflation protection. "The best way for a saver to have pure indexation is to buy utility shares. They yield 5% and their dividends will go up on an RPI-adjusted basis. It is a no brainer," he said.

He added investors concerned over both inflation and a spike in bond yields could look to use swaps.

"If it was your view that government bond yields are too low, inflation swaps could provide inflation protection and hedge out interest rate exposure. But our view is bond yields in general will stay low, and longer-dated bond yields could even fall."

But M&G's head of [investment](#) specialists Anthony Doyle said he has concerns over the liquidity of the swap market. "We do not use swaps so much because it is quite a small marketplace, which can have an impact on returns," he said.

A further complication for investors looking for inflation protection could arise if the UK's Debt Management Office (DMO) starts to issue bonds linked to CPI instead of RPI. The DMO has just finished a consultation period on the subject following calls from some pension funds for CPI issuance to help aid liability-matching.

"RPI issuance is going the way of the dinosaur. You will see the DMO announce CPI index-linked gilt issuance, and in our view that is another reason to buy RPI-linked assets now," said Doyle.

But Kames' McNeill said the DMO would be careful not to create a two-tier market. "The DMO will be very conscious not to fragment the market. It would be concerned about the operational efficiency of the market if it introduces another instrument".

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