Inflation proof your portfolio

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SPECULATION HAS been rife in the media about the extent of a rate hike by the Reserve Bank of India in its policy review meeting next week — the question being asked is not "Will there be a rate hike next week?" but "How much will the hike be?"

Remember that if the hike does happen, it would be the fourth by the central bank in four months, despite the uncertainty of global growth with slowdown data points coming in from the US, Europe and China. Whilst these rate hikes can be looked upon as a normalisation process since rates were cut sharply during the global crisis in 2008, the biggest worry for RBI and the government has been inflation.

Inflation continues to be in double digits irrespective of the number that you look at — 13.9 per cent for May for Consumer Price Inflation (CPI), 12.8 per cent for food inflation and 10.5 per cent for Wholesale Price Inflation (WPI).

Whilst the policy makers believe that these numbers are likely to come down as the year progresses due to the higher base effect and on the back of a good monsoon, we believe it is too early to have any clarity on the extent to which inflation will get tamed.

We will need to remember that the extent of increase in global money supply over the last couple of years has been unprecedented. Add to that the erratic monsoon so far, and you could have a recipe for a serious inflation problem.

A pure fixed income portfolio is unlikely to be inflation proof. Empirical data over the last 15 years seems to indicate that a 40 per cent debt, 35 per cent equity and 25 per cent gold exposure could be a good mix to begin with.

The recent data on the demand supply for pulses, which India is the largest consumer of, seems to indicate that the shortfall for pulses will take 2-3 years to address.

Considering all of this, we believe it is critical to start building a portfolio that can help fight this inflation, at least partially.

■ **Conservative investors may need to get more aggressive:** Since the real rate of return (i.e. earnings from fixed income instruments less inflation) continues to be negative, a pure fixed income portfolio is unlikely to be inflation proof.

Fixed income portfolios will need to have some equity and gold exposure added to them. This could be done either through buying standalone equity/gold offerings or through the use of hybrid products wherein these are premixed at different levels.

In case of taking standalone exposure, please do so through a systematic route as both equities and gold have risen rapidly over the last year. Empirical data over the last 15 years seems to indicate that a 40 per cent debt, 35 per cent equity and 25 per cent gold exposure could be a good mix to begin with.

■ **Floating rate loans will need to be paid off as quickly as possible:**

With the deposit growth having slowed down significantly and credit demand starting to pick up, you can expect loan rates to start increasing in the coming months. Start prepaying your floating rate loans.

■ **Explore using floating rate/variable rate saving instruments:** There are mutual funds and deposit products available that reset interest rates both upwards and downwards for investors. Since interest rates are likely to move up, these could be explored as investment options.

Finally, hope that TIPS (Treasury Inflation Protected Securities), which are prevalent in the US since the late 1990s, wherein returns are linked to inflation, find their way into India soon.

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