



INSIGHTS FROM
 CFA SOCIETY SINGAPORE

By Galit Ben-Joseph

How to talk to clients about inflation

Have current figures as well as the context ready to help answer their questions

AS FINANCIAL advisers, we often have clients coming to us with various questions about gross domestic product, unemployment, interest rates, consumer consumption, and how these numbers can affect the market and their investments. I like to be prepared and have the current figures ready for my clients, as well as the context to help answer their questions.

Lately, clients have noticed the rising costs across many of their expenses: groceries and rent, to name a couple. Naturally, they may be frustrated and turn to us to help them understand what's going on. Why is everything more expensive? What's causing record-high inflation?

Such discussions require that we have more than a quick stat or two at the ready. There is a lot of context we may need to fill in to explain the current situation. We might have to sit down and explain the many correlations, relationships, and effects of rising prices. What is really happening in the economy right now? How will central banks try to solve it? Can they?

Here are a few tips to approach these conversations with clients:

Define inflation

First off, it may help to explain to clients what inflation is and why it matters in the long term. Put simply, inflation is the increase in prices of goods and services. It raises the cost of living: over time, it takes more money to buy the same items and the consumer's purchasing power declines.

To be sure, consistent, incremental inflation is necessary for a healthy economy. If inflation is too low, that indicates a low demand for goods and services and can lead to a potential economic slowdown. However, inflation becomes a problem when it is too high. Left unchecked, sustained high inflation can slow the economy and erode savings. This is why we need to work closely with clients to help them find ways to sustain their purchasing power over time.

Explain how we got here

Clients may ask: How did we even get to this point? The causes of inflation vary, but they tend to be products of the economic principles of supply and demand. While there are other variations, economists typically categorise inflation into two core types: demand-pull, where demand for goods and services increases, but supply does not keep pace; and cost-push, where the supply of goods and services falls, but demand for them does not.



Inflation will affect clients differently depending on their portfolios. PHOTO: PIXABAY

Today's persistent inflation has no single cause. Rather, multiple factors in the global economy contribute to it.

Supply-chain issues created a shortage of goods and materials. This was exacerbated when many factories temporarily halted production in China due to the country's zero-Covid policy. Meanwhile, trillions of dollars in United States government stimulus propelled a robust recovery from the pandemic-fuelled economic crisis and, in turn, increased both income and demand. Record low US unemployment and a tight labour market brought wage growth. Then, the Russia-Ukraine war reduced the global supply of oil, wheat, and other commodities.

Explain what the Fed's rate hikes have to do with this

Why and how do interest rate hikes relate to lowering inflation? The US Federal Reserve has a dual mandate to promote maximum employment and stable prices. If it seems like prices are rising too quickly, the Fed will raise interest rates to try and contain inflation by increasing the cost of borrowing – affecting credit cards, mortgages, and so on. This reduces demand, which could lead to lower prices.

The Fed will also lower rates when it wants to spur economic activity. For example, during the 2008 financial crisis, the discount rate was set to zero. To stimulate consumer consumption, the Fed lowered rates so people would borrow to buy goods and services, start businesses or increase inventories. This is how it works in theory: more consumption or spending leads to more growth, more people to hire, more pay cheques cashed and, again, more consumption.

Today, by raising interest rates, the Fed wants to increase the cost of credit. That tends to make

people less willing to borrow and in turn less willing to spend. For example, a client may decide to buy a new house with a 3 per cent mortgage, but a 5 per cent mortgage may push it out of their price range. As interest rates on savings accounts rise, more people may be encouraged to put their money in the bank instead.

The thought process goes something like this: higher rates mean a tighter and more limited money supply. Consumers will therefore spend less. Higher rates can thus "cool" the economic landscape. To go back to basic economic theory: less demand means lower prices.

Help clients manage the impact

Everyone has different circumstances, priorities, and long-horizon goals. This is why it's important for clients to have a long-term financial strategy that aligns with their personal goals. Inflation can affect day-to-day expenses, but it also has implications on long-term planning. This is why we need to periodically review their allocations with them.

Clients may ask if they should adjust their portfolio right now. The truth is there isn't one "right" answer for everyone. Inflation affects every sector differently. We need to talk to our clients and take a comprehensive look at their entire financial outlook, and discuss where each asset class is headed.

What we do know is that diversified portfolios tend to perform the best over time, regardless of the inflationary environment. We also know that clients need us, their advisers, when there's uncertainty – and this year is certainly providing plenty of that.

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