



Guide To...

Inflation – The Primary Investment Risk

What are real returns?

In financial planning, it is important to protect income and capital from the primary risk of inflation. Inflation reduces the purchasing power of money. The return on an investment above the level of inflation is called the real rate of return. When investing, you should aim at the very minimum, to achieve a positive real rate of return.

What returns can you expect?

With fixed interest investments, you can reasonably expect a real rate of return of around 3% *per annum* over the longer term. This rate of return reflects the relatively low level of risk associated with fixed interest investments (also referred to as bond funds). However, the level of return can vary widely depending upon economic and financial market conditions. For example, in the 1960s Australia's real fixed interest returns were sometimes negative. That is, these investments offered returns less than the inflation rate. More recently, in 1994, investors lost money on fixed interest investments even before taking inflation into account.

Growth investments, such as shares and property, tend to have higher real returns over the long term. This is because they offer compensation for the greater variability of returns and cashflow. Dividend payments on stocks are generally more variable than interest repayments on debt. Individual fixed interest instruments offer a predetermined repayment of capital at maturity. This certainty of an end-value is lacking with growth investments that have an indefinite life. Over a longer period of time, you can reasonably expect real returns of between 3% to 6% *per annum* on growth investments.

If you have any queries in relation to the content of this material, please do not hesitate to contact Kate Kimmorley the Principal Financial Adviser at Kimmorley Financial Management on (07) 5591 1725.

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