

ETFs for 20% Inflation

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In recent months, an increasing number of investors have become convinced that the "perfect storm" for hyperinflation is brewing. To combat the worst recession in a generation, Washington (along with other world leaders) has ushered in stimulative monetary policy and major tax cuts, thereby expanding the trade deficit and establishing new records for government debt.

Although price increases to this point have been very low (in fact, worries of *deflation* have abounded), investors are well aware that there will eventually be a price to pay for spending (or trying to spend) our way out of a recession. While higher rates of inflation in the future are inevitable, the question now is just how high they will go.

The fear is that when the time does come to pay the piper, we won't experience inflation at the high end of the Fed's 2%-3% "comfort zone," but rather rates that break into the double digits. Increased concern for such a worst case scenario have sparked the launch of funds betting on hyperinflation and caused a flood of inflows into many [precious metals ETFs](#).

The Case for Hyperinflation

36 South Investment Managers Ltd., whose Black Swan fund returned 234% in 2008 by betting on risk-aversion events, recently launched a new fund aimed to profit in a high inflation environment. The Excelsior Fund will target a rate of return equal to five times the inflation rate in the Group of Five Economies (U.S., U.K., [France](#), [Germany](#), and [Japan](#)) should such rate exceed 5%.

Jerry Haworth, the firm's co-founder contends that "there is a sharply increased risk of greater than 5% inflation starting from now. We are in the lag period between when the seeds of inflation are sown and when their offspring, that is higher prices, are evident for all to see."

And 5% inflation isn't Haworth's worst case scenario - it's actually far from it. "There is certainly talk about inflation but people might think of inflation at 5% or 6%," the Zimbabwean-born Haworth said. "We're talking 5%, 10%, 15%, 20% or more." In order to deliver such returns, the Excelsior Fund will buy long-dated options it believes are undervalued, including options on commodity and stock prices, bond yields, and currency volatility.

Universa Investments LP is also introducing strategies that bet on failed stimulus efforts resulting in extremely high inflation rates, although this fund may be out of reach for most as it will require a minimum investment of \$25 million. Universa is advised by Nassim Taleb, the economist behind the "black swan" theory of highly-improbable events.

In 2008, 36 South's Black Swan Fund generated its jawdropping gains by betting on interest rate cuts in New Zealand and Australia and buying put options in [BRIC countries](#), which were among the hardest hit during the global recession.

ETF Plays for a Hyperinflationary Environment

While hyperinflation would be an extremely adverse development for the broad global economies, there are certain investments that would perform well in such an environment.

- **[SPDR Gold Trust \(GLD\)](#)**: Gold is renowned as an inflation hedge and generally performs well during periods of crisis. As the value of the the world's reserve currency (U.S. dollar) declines, investors flock to gold as a store of value. In May, GLD had the largest monthly inflow among ETFs at more than \$450 million.



- **[iShares Silver Trust \(SLV\)](#)**: Although not as popular as gold, silver also acts as an inflation hedge. As investors have sought hedges to risk, silver ETF holdings have risen in recent months. In mid-June, SLV added almost 120 tonnes of silver, bringing its holdings to a record level of 8,724.86 tonnes.
- **[iShares Lehman TIPS Bond Fund \(TIP\)](#)**: This ETF invests in inflation-protected securities issued by the [U.S. government](#). Since the payments issued to holders of these securities are contingent upon the rate of inflation, investors in TIP will see their nominal return increase with inflation, essentially allowing them to lock in a real return.

Disclosure: No positions.

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