

Why Invest?

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Every now and then a question comes up that makes you take a step back and think. Sometimes the simple questions are the hardest to answer; for example, we were recently asked the question, “why invest?”

The fundamental answer to that question is that aggregate savings fund aggregate investment through both public and private channels. Your savings are the other side of the investment that powers growth. Countries with high savings rates tend to have high investment rates.

In the case of the UK, we have tended to save less than we should and traditionally we have relied on imported capital to bridge the gap between desired investment and desired savings. The UK runs a, more or less perpetual, current account deficit.

There is, of course, a balance to be struck. Germany, in aggregate, has too much saving (or too little domestic investment) so those excess funds tend to be lent to other countries. At root, this was the key problem underlying the Euro crisis of 2010: excess German saving funding excess borrowing in the ClubMed.

The US saves too little and like most developed economies it has very low interest rates, but unlike most economies, the US has little problem in attracting capital even though it too saves too little. The US dollar and US financial assets are still regarded as the world's reserve assets and in a crisis, that is where money tends to flow.

But that explanation doesn't really answer the question for most people in their ordinary working lives.

The more relevant answer for most of us to the question “why invest?”, is twofold: opportunity and cost.

Take cost first: one of the most important reasons to invest is that money tends to lose value over time. After all, money is only as valuable as what it can be exchanged for; you can't eat pound notes (remember them!) but you can eat bread.

Ay, but there's the rub, as Hamlet might have put it because, like nostalgia, £1 today isn't what it used to be.

The Office of National Statistics keeps a helpful database of the price of our daily bread. Back in 1970, the British pound would buy you 11.11 standard British loaves at 9p each. By the end of that decade, that same pound was only worth three loaves, by 1992 only 2 and in 2010, your pound would only buy you 23 slices of a standard 28 slice loaf. In 2010 a loaf cost 120p.

Generally speaking, we have lived through a lengthy period of low inflation but even low rates of inflation can erode the value of money very quickly. In fact, between 2000 and 2010 the value of money, expressed in terms of loaves of bread, more than halved.

But turn the telescope around and you see the opportunity. Had I bought a loaf of bread in 1970 for 9p, I could have exchanged the same loaf for 120p in 2010 and made eleven times my original outlay, protecting the real value of my original capital and, in this example, turning in a “real” profit ahead of general inflation.

I realise that it would be a strange loaf that would last that long and even if it did, you wouldn't want to eat it, but substitute the loaf for a more conventional investment and you see the point. We can't invest now in future inflation, but we can buy

assets which grow faster than the inflation which lies ahead.

Money itself is useful for exchange and as a unit of account but is generally a poor store of value.

It is an important issue at the moment because inflation rates look like they are beginning to edge up after quite a long period of disinflation. To be slightly more technical for a moment: the scale of the fiscal response to Covid, allied to a large amount of “pent-up” demand, coupled to fragmenting global supply chains (or deglobalisation) is likely to put upward pressure on global prices. Inflation is quite likely to accelerate.

So, in short, the answer to the question, “why invest?”, is simply that in the long run, money itself isn’t a terribly good investment.

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