

28 May 2008

QIC ADOPTS INNOVATIVE APPROACH TO INFLATION PROTECTION

The gloomy global inflationary outlook has prompted QIC to develop an innovative approach to protecting investments from inflation 'spikes'.

QIC has implemented a strategy that uses synthetic securities (or 'inflation swaps') to provide a more flexible and tailored approach to mitigate the impact of inflation on investment portfolios.

Inflationary pressures are being caused by five years of above-trend economic growth and strong population growth outstripping the supply of a number of commodities.

The combination of these factors means that inflation protection measures will become an increasingly important aspect of investment portfolio management.

QIC Managing Director of Active Management Susan Buckley said that recent research had disproved previous held views on hedging against inflation.

"Many investors have previously believed that equities represent a hedge against inflation, yet recent research goes against this thinking," she said.

"The latest research actually shows that traditional assets such as bonds, equities and property are actually not correlated with inflation spikes over short to medium-term periods. Inflation swaps and commodities provide the best hedge against inflation spikes."

The traditional approach for hedging inflation risk is to use inflation linked bonds but there are some significant factors that impact on their effectiveness.

"The effectiveness of inflation-linked bonds is impacted by three key factors," Ms Buckley said.

"First, they are difficult to access. Second, using physical assets limits your exposure to the extent that the inflation linked bonds have been issued. For example, currently there are no inflation linked bonds with maturities beyond 2020.

"The final drawback in using physical securities is that they require a 100% capital allocation to achieve the desired exposure. So the only way to increase exposure is by increasing your capital allocation".

Rather than using physical assets, QIC has implemented a strategy that uses synthetic securities.

"We can generate better investment outcomes for clients through the use of derivatives called 'inflation swaps'," Susan said.

"These customised securities provide greater flexibility and capital efficiency.

"In other words, we can generate the same exposure as physical assets but without the same level of capital allocation. This frees up cash to invest in other alpha or beta opportunities.

"Clients also benefit from our global approach to inflation hedging. Our strong global network of contacts allows us access to the best securities to provide the best inflation hedging solution for clients," she said.

QIC is one of Australia's largest institutional fund managers with more than \$70 billion currently under management for its Australian and overseas clients.

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