For Financial Advisers Only

THE GREAT RACE FOR RETURNS AGAINST INFLATION

BY CHESHTA DHINGRA

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Imagine a racetrack buzzing with excitement, brightly coloured cars lining up, engines roaring, ready to speed towards the finish line. This isn't just any race; it's the Great Race of Returns, where your investments battle it out for the best performance.

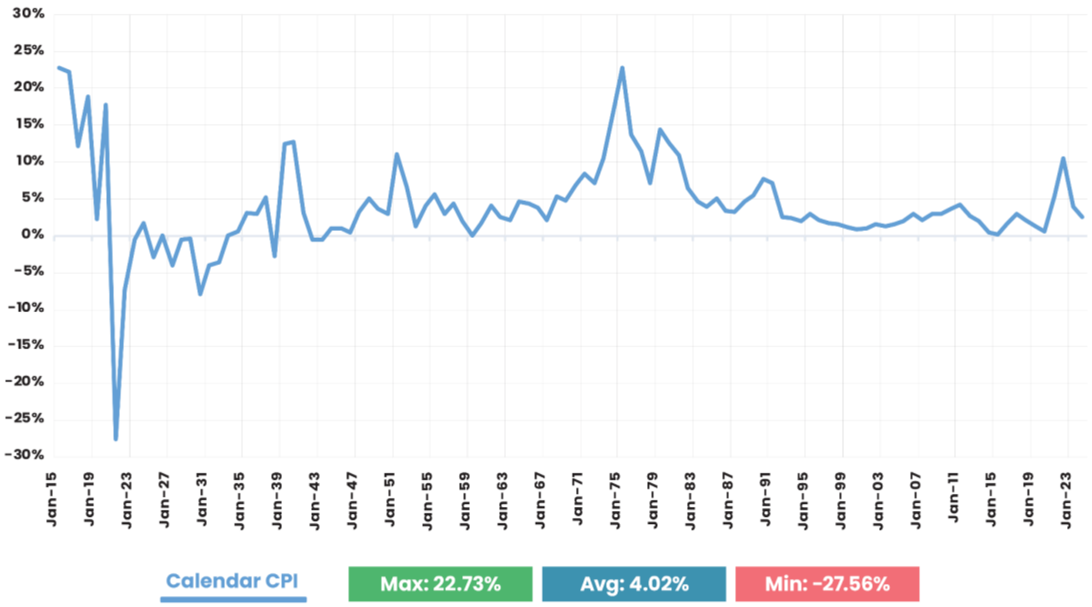
Ladies and gentlemen (read: astute investors), start your engines! Welcome to the thrilling Great Race of Returns, where your money takes the wheel in a high-octane battle against time and inflation. Buckle up, because this race will reveal why the results on our ecosystem dashboard show such wild differences in performance, sometimes blazing ahead, other times sputtering out.

When you're behind the wheel of a high-speed race car, the speedometer needle climbs higher and higher. The thrill is exhilarating as you zoom down the track at 100 mph. This, in the world of investments, is akin to your nominal returns, the flashy, immediate indication of how fast your investments seem to be growing. But here's the catch: The true measure of your speed, or real returns, is adjusted for the road conditions, representing inflation.

Nominal returns are simply the raw numbers, the growth of your investments without any adjustments. Real returns, on the other hand, factor in inflation, providing a clearer picture of your purchasing power. So, if you're speeding along at 100 mph (nominal return) but the track is slick with inflation, your real speed might only be 70 mph. This means that despite the impressive numbers, your investments aren't growing as fast as they seem. At Timeline, we ensure our drivers understand the critical difference between these two metrics.

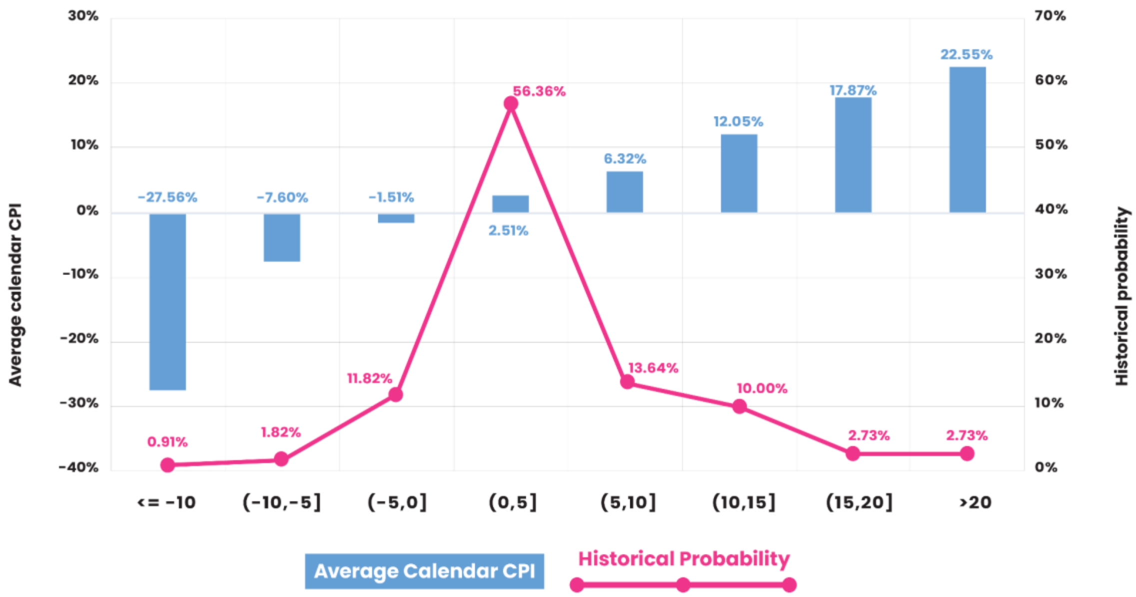
Just as rain, fog, or a smooth surface can drastically alter a race, inflation affects the value of your returns. It can either smooth the way, creating ideal conditions for growth, or present hazards that slow you down. Inflation is the rate at which the general level of prices for goods and services rises, eroding purchasing power. To measure this, we often refer to the Consumer Price Index (CPI) and the Retail Price Index (RPI). RPI includes housing costs like mortgage payments, rent, and council tax, while CPI does not. Over time, these indices move in tandem, with an average annual difference of about 1%. During the financial crisis in 2009, Bank of England Base Rate fell to zero, causing RPI to plummet below CPI, a rare occurrence.

At Timeline, we use advanced forecasting tools to predict assess the potential impact of inflation, sourcing our data from the Bank of England and the Office for National Statistics (ONS). As you can see below, the first chart displays the annual inflation rates since 1915. Here, we observe considerable variability over time, reflecting the dynamic nature of economic conditions. The highest recorded inflation rate during this period was 22.7%, while the lowest was -27.6%. On average, the inflation rate over these years has been 4.02%.

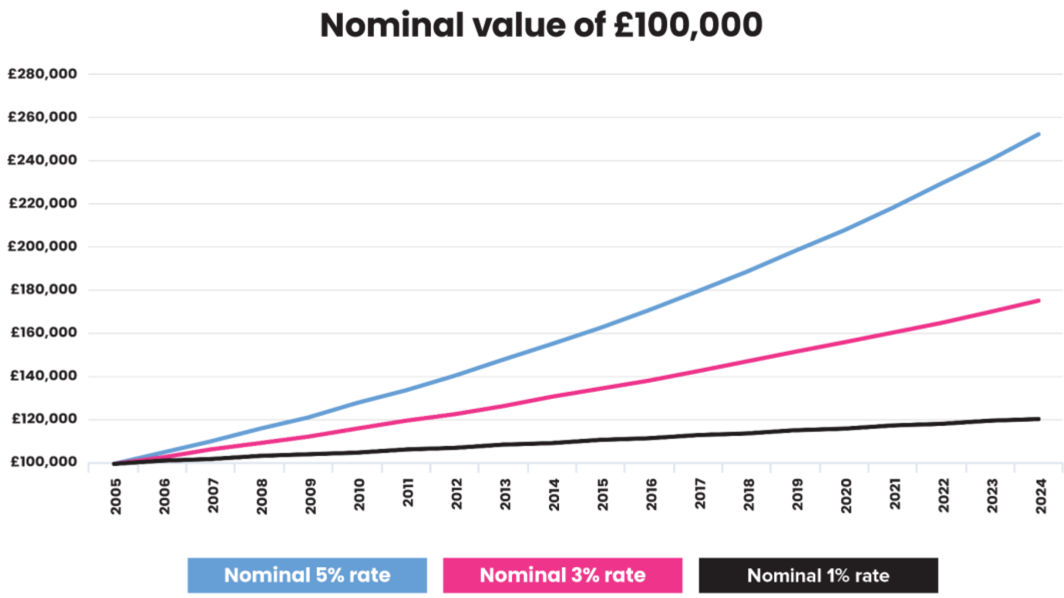


The second chart illustrated the distribution of these annual inflation rates observed since 1914, offering insight into their historical probability. Notably, in 56.4 % of the years, inflation rates fell between 0 % and 5 %. The historical probability of inflation rates ranging between 0 % and -5 % (i.e., deflation) was 11.8 %, while the probability of rates between 5 % and 10 % stood at 13.6 %. Higher inflation rates (10-15 %) occurred in 10 % of the years, and very high inflation rates (15-20 %) were recorded in 2.7 % of the years. Inflation rates exceeding 20 % remained quite rare, occurring in only 2.7 % of the years. Overall, in approximately 72 % of all observed years, annual inflation stayed at or below 5 %, meaning that inflation rates above 5 % were recorded in roughly 28 % of the historical record.

These charts highlighted the historical range and probability of inflation outcomes observed over the past century. Understanding the patterns that actually occurred in the past can provide useful context when evaluating how different investment strategies performed across a wide variety of historical inflation environments.

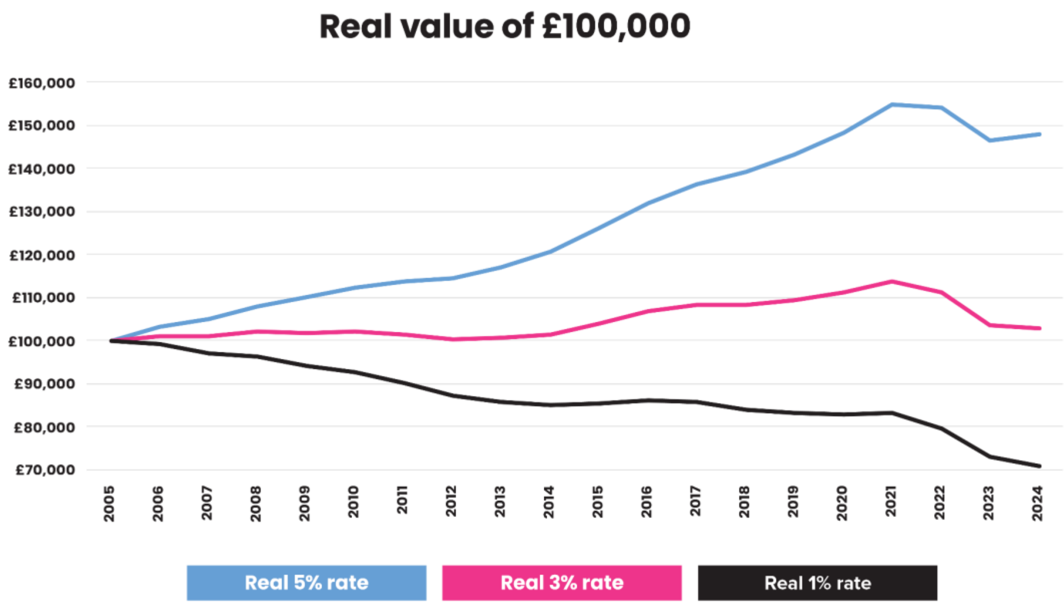


Let’s dive deeper into why it is so crucial for clients' investment to be on track with inflation. The chart below shows the nominal speed of three cars (savings accounts) with 1%, 3%, and 5% annual interest rates over the past two decades. The car with the 5% rate zooms ahead, followed by the 3% and 1% rates. On the surface, it seems like all three cars are gaining ground and speeding towards financial success.



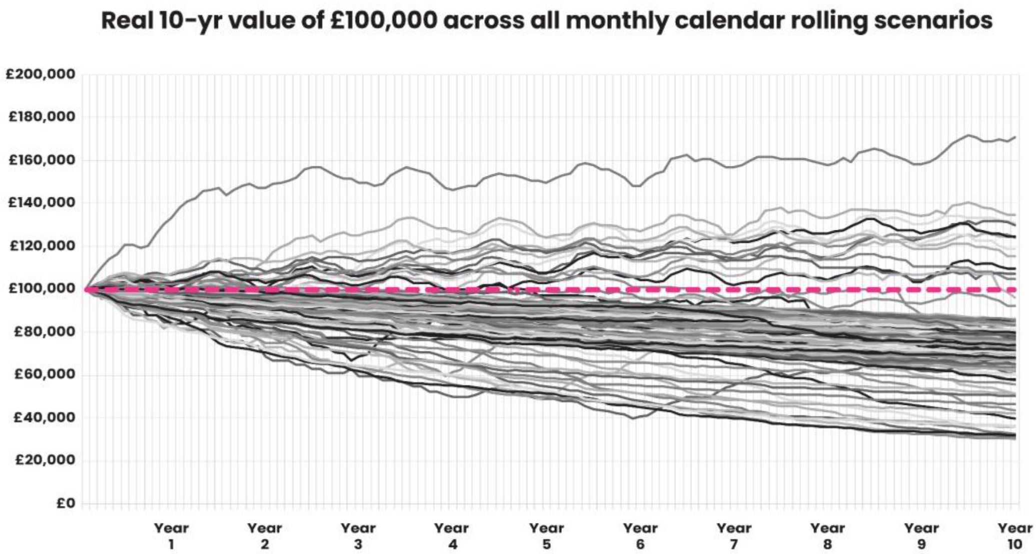
Investment Divergence: Final Portfolio Values Range from £120,811 to £252,695

However, the second chart below reveals the true speed by factoring in inflation - the road conditions that affect your journey. When adjusted for the Consumer Price Index (CPI) inflation over the last two decades, the real speed (value) of these savings accounts changes dramatically. The cars with 3% and 1% annual interest rates actually fall behind, resulting in a real value less than the original deposit of £100,000. This shows how inflation can erode your purchasing power, making it seem like you’re moving forward when, in reality, you’re losing ground.



Long-Term Impact: Real Portfolio Values Span from £70,732 to £147,948

Going a step further, the third chart examines all monthly rolling 10-year scenarios since 1915, showcasing the real value of £100,000 in cash with a 0% interest rate and no additional contributions over ten years, considering varying inflation sequences. The lack of interest return starkly highlights the erosive power of inflation over time. In 70% of these scenarios, the real value of £100,000 after ten years would have diminished to less than £70,000. This demonstrates how inflation can act as a persistent headwind, slowing your progress despite seemingly favourable conditions. Even with no apparent losses, the purchasing power of cash steadily erodes in the face of inflation, making it clear that simply holding cash is far from a risk-free strategy over the long term.



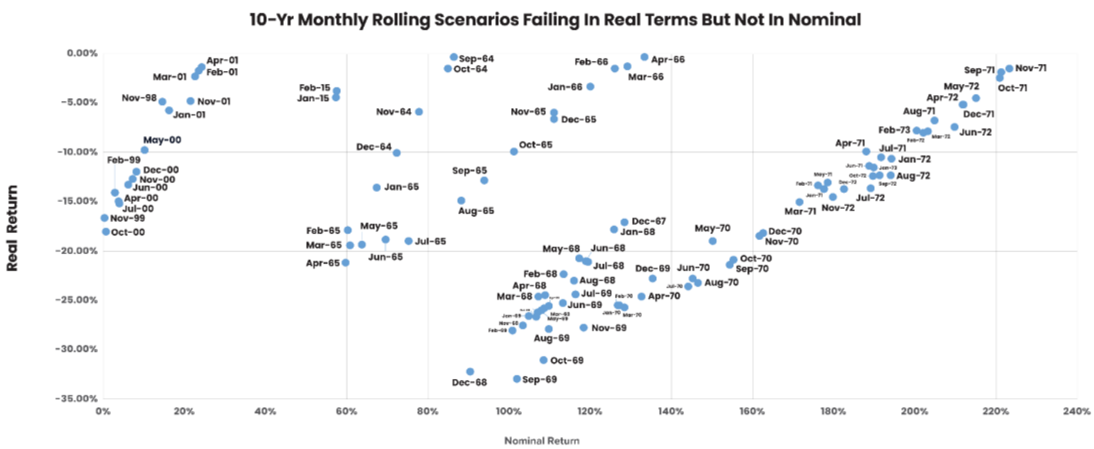
Scenarios	<-30%	[-30%, -20%)	[-20%, -10%)	[-10%, 0%)	>= 0%
1201	39%	32%	16%	1%	13%

These charts highlight the crucial need to factor in inflation. Nominal returns might dazzle, but without considering inflation, they can be a mirage. At Timeline, we gear up our drivers (investors) with the right tools and savvy strategies to tackle inflation head-on. We aim to ensure their wealth doesn’t just grow in numbers but retains real value, helping them cross the finish line with their purchasing power intact. Buckle up and race smart with Timeline!

Beyond the Speedometer: Crafting a Financial Plan That Truly Goes the Distance

Now that we know all about the game, let’s dive into the fun part. In the high-stakes race of investing, it's not just about how fast you think you're going (nominal returns) but how fast you're actually progressing given the road conditions (inflation). Understanding the interplay between investment returns and inflation is crucial for back-testing the sustainability of a financial plan. You need to evaluate both to see the true performance of your investments over time.

The chart below illustrates all 10-year monthly rolling scenarios for Global Equity (Morningstar Global All Cap Target Market Exposure Index) where the 10-year cumulative nominal return was positive, but the real return, adjusted for inflation, was negative. The x-axis shows nominal returns, while the y-axis displays real returns. Each point on the chart represents the 10-year cumulative return in both nominal and real terms.



Key Points to Understand:

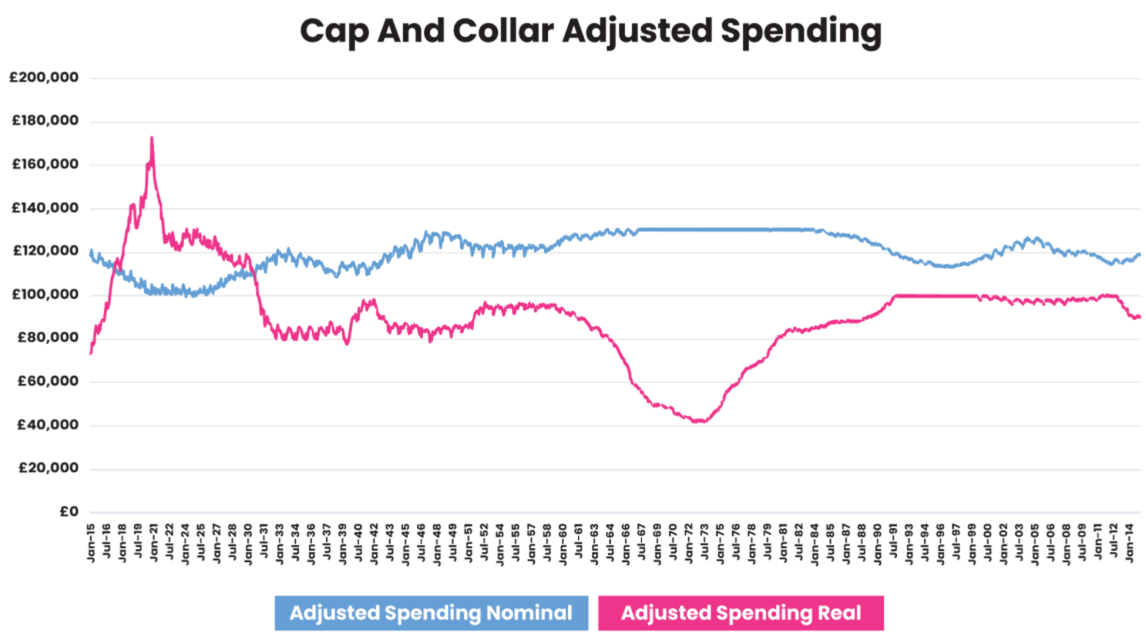
1. **Nominal vs. Real Returns**: Imagine seeing a car speedometer hitting over 150 mph, only to realise the actual speed (real return) is much slower or even negative due to poor track conditions (inflation). The chart shows several scenarios where nominal returns exceed 150% but result in negative real returns. This vividly illustrates the necessity of considering inflation. Making assumptions about inflation or using straight-line projections can be dangerously misleading. Inflation must be accounted for to understand the true growth of investments.

2. **Worst Case Scenarios**: The worst-case scenario in nominal terms isn't always the worst in real terms. As the chart shows, the worst 10-year scenario in nominal terms differs from the worst in real terms. This discrepancy arises from the sequence of inflation and its significant impact. This concept applies across all long-term horizons, with the 10-year horizon as just one example. Moreover, it applies to various asset classes, with Global Equity as the example here.

3. **Impact of Bespoke Inflation Rules**: If clients use bespoke inflation rules, such as a 3% cap and a 0% collar, they still need to consider the real value of their spending based on actual inflation, not just the capped or collared rates. The full impact of inflation on purchasing power must be acknowledged, even if bespoke rules provide some protection or predictability. Understanding this real-world impact is crucial for accurate financial planning and sustainability assessments.

In summary, while nominal returns are an essential part of investment performance, ignoring inflation can create a false sense of security. Real returns provide a clearer picture of the actual growth and sustainability of investments. Incorporating inflation into financial planning is essential to ensure that investment strategies remain robust over time.

To further illustrate, consider the chart below, which shows the terminal value of £100,000 spending in both nominal and real terms for all 10-year monthly rolling scenarios, with spending annual inflation adjustment capped at 3% and collared at 0%. This means that if the CPI of a year was higher than 3%, the spending will be adjusted for 3% and no more than that. Similarly if there was deflation, the spending would not decrease. Instead it will stay the same.



This chart shows how nominal spending might seem stable or slightly increased due to the cap, but real adjusted spending (in pink) declines noticeably in scenarios with high inflation sequences. This is due to the fact that in several years the actual CPI was greater than 3%. And so, capping to 3% will diminish the real value of spending. This underscores the importance of back-testing a client's financial plan for real returns, not just nominal returns, ensuring the plan's long-term viability, especially under high inflation scenarios.

Ultimately, incorporating inflation into financial planning is crucial to ensure that your investment strategies remain resilient and effective over time. And of course, at Timeline, we provide the insights and tools needed to help navigate this complex race, helping you reach the finish line with your purchasing power intact.

Cross the Finish Line in Style: Thriving Through Inflation with Timeline

In the thrilling race of investment, understanding the real speed of your car (investments) against the ever-changing track conditions (inflation) is paramount. We've zoomed through the critical distinctions between nominal and real returns, highlighting how inflation can stealthily erode seemingly impressive gains. The key takeaway? Inflation is the hidden adversary that can turn a triumphant race into a stalling halt if not accounted for properly.

At Timeline, we give our investors a highly capable pit crew of tools and strategies tuned to the challenge of delivering sustainable real returns over the long term. We integrate real returns into every aspect of our planning and portfolios, ensuring your clients' wealth doesn't just grow but maintains its true purchasing power.

Our approach isn't just about hitting the finish line; it's about crossing it in style, with your financial health intact and thriving. With Timeline, you're not just in the race, you're leading it, fully equipped to navigate any twists and turns inflation throws your way. Buckle up, and let's keep that engine roaring towards sustained financial success!

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Email support@timeline.co

Office 70 Gracechurch St
4th Floor
London
EC3V 0HR

timeline.co

TL-044-25-V6