In this paper, a dynamic inflation-protected investment strategy is presented which is based on traditional asset classes and Markov-Switching models. Different stock market as well as inflation regimes are identified and within those regimes the inflation hedging potential of stocks, bonds, real estate, commodities and gold are investigated. Within each regime, we determine optimal investment portfolios driven by the investment idea of protection from losses due to changing inflation if inflation is rising or high but decoupling the performance from inflation if inflation is low. The results clearly indicate, that these asset classes behave differently in different stock market and inflation regimes. Whereas in the long-run we coincide with the general opinion in the literature that stocks and bonds are a suitable hedge against inflation, we observe for short time horizons that the hedging potential of each asset class, especially of real estate and commodities, depend strongly on the state of the current market environment. Thus, our approach provides a possible explanation for different statements in the literature regarding the inflation hedging properties of these asset classes.
A dynamic inflation-protected investment strategy is developed, which combines inflation protection and upside potential. This strategy outperforms standard Buy-and-Hold strategies as well as the well-known 1/N–portfolio.

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