How to Avoid Canada's Top 3 Economic Risks

Description

In a recent op-ed in the *Financial Post*, Gluskin Sheff chief economist David Rosenberg listed his top 10 risks to the Canadian economy. Some of them were quite obvious, such as Quebec sovereignty, a rejection of the Keystone pipeline, and spillover effects from the crisis in Ukraine.

But there were three risks that stood out from the rest, and it is important for Canadian investors to remain aware of them. Below are Mr. Rosenberg's top three risks, in reverse order:

3. Interest rate increases

A sharp rise in interest rates (in either Canada or the United States) would have severe effects on the economy, businesses, and of course, stock prices. Companies with heavy debt loads would see their borrowing costs rise. Consumers would be more inclined to save money rather than borrow and spend. The value of bonds and dividend-paying companies would suffer. And the prices of precious metals would take a hit, hurting the companies that mine them too.

But there is one industry in particular that would benefit from higher interest rates: insurance. Canada's largest property and casualty insurer, **Intact Financial** (TSX: IFC), is a perfect example. The company takes the cash from insurance premiums and invests them primarily in bonds, which currently yield very little. In fact, stocks make up only 22% of the company's investment portfolio. Intact is anxiously awaiting rate hikes, making its shares a great way to bet on that happening.

2. High provincial debt levels

This is an especially high risk in Quebec and Ontario, and could lead to future tax increases. Within these provinces, certain companies will be more affected than others.

The companies that have the most to lose are mining companies like **Detour Gold** (TSX: DGC) and **Osisko Mining** (TSX: OSK). Both of these companies produce all their gold from just one mine – Detour in Ontario and Osisko in Quebec. And if their taxes or royalties are raised, they cannot leave for cheaper jurisdictions. Investors worrying about this risk should probably avoid these companies.

3. A Chinese hard landing

There is no denying that this is an extremely serious risk for the Canadian economy. Many economists believe that China's rise is built on unstable ground and that eventually the country's economy will come back down to earth. While this is up for debate, such an outcome would be devastating for Canada's natural resource sector, above all the base-metal miners.

For example, **Teck Resources** (TSX: TCK.B)(NYSE: TCK) would be seriously affected by a Chinese hard landing. The company makes its money from metallurgical coal, copper and zinc – the prices of all three of those commodities are determined by conditions in China. Investors looking to soften the blow from a Chinese hard landing should certainly avoid Teck's shares.

Foolish bottom line

It is impossible to completely avoid every economic risk. And for that reason, it would be a mistake to worry about these headlines more than necessary. Just like in any other economic cycle, you should focus instead on buying good companies at attractive prices. And if you have enough patience, you can wait out any and all economic risks until they seem like distant memories.

CATEGORY

1. Investing

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1. NYSE:TECK (Teck Resources Limited)
2. TSX:IFC (Intact Financial Corporation)
3. TSX:OSK (Osisko Mining)
4. TSX:TECK.B (Teck Resources Limited)

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