Consumer Debt Continues to Rise in Canada: 4 Ways it Could Affect Your Portfolio

### Description

Debt levels are an important variable for investors to watch for at all times, as credit is one of the most important functions of modern economics. Without credit, much of what we know today wouldn't exist.

The levels of debt among consumers, therefore, become even more important, as it helps gauge the level of the economy, but it also helps forecast what is coming next.



As consumer debt levels continue to rise, it will inevitably lead to change in the economic system. Not only will debt levels have to normalize, but the process could take the form of several different ways.

Consumers themselves may slowly start to reduce debt levels, or a shock to the economic system could force people into debt reduction.

Whatever happens, investors need to be ready with a plan and understand how it may affect their portfolios. Below are four different ways rising debt levels could affect your portfolio.

## Consumer discretionary stocks

As Canadians eventually start to reduce their debt, it undoubtedly will have an effect on the companies selling discretionary goods. As the name suggests, discretionary goods are those goods that are bought only after necessities have been paid for.

At current consumption levels, consumer debt continues to grow, this suggests that to just keep debt levels flat, there would have to be a reduction in discretionary spending. Taking it a step further, in order for debt to be reduced, consumers will have to cut their discretionary spending even more to have the money to pay down debt.

This will undoubtedly have a major impact on consumer discretionary stocks such as **BRP** (TSX:DOO)( NASDAQ:DOOO). BRP sells large, expensive goods such as snowmobiles and jet skis. It's no surprise that goods like these are discretionary and will be impacted if the economy slows down in Canada.

Furthermore, with discretionary companies like BRP that sell goods that often need financing, it could be even more of a problem. Less people will demand BRP's goods, and for the consumers that may still want to buy the goods, they may not receive financing if credit markets dry up. This makes it paramount for investors to know how much of their portfolio is exposed to discretionary items.

## Bank stocks

Although a slowdown in consumption is never ideal for a country's GDP, a natural reduction in spending would be a better situation than a forced reduction due to an economic shock. Bank stocks in Canada have been all the talk lately, as investors try to figure out how exposed the banks are.

The main worry investors have is with mortgages, but as debt levels rise all together, all debt will naturally see a rise in delinquencies. This will affect the banks, and whether it impacts them meaningfully or not, the stocks will see a big dive as investors flock to safety. Having a plan for when this happens could be key for your portfolio's future.



## Defensive stocks

Although defensive stocks won't necessarily see a boost to the underlying business as debt is reduced, the stocks should outperform more discretionary stocks, as investors seek some companies with stable cash flows.

Due to the debt levels being at record highs for years, defensive stocks have already been bid up pretty high, but adding to them now may still help your portfolio to outperform in poor economic times.

## Stocks with foreign exchange exposure

If Canada has an economic shock on its own, it could impact stocks that are exposed to currency risk. The bank of Canada could be forced to lower interest rates, impacting the Canadian dollar by making it worth less in comparison to its trading partners.

This will increase the income of Canadian companies operating abroad where the money is being brought back to Canada and changed to Canadian dollars. In contrast, companies that import their raw materials or goods to sell from other countries, will take a big hit as their imports will become more expensive.

## Bottom line

Even if your portfolio is well diversified, it is paramount to understand how debt levels in Canada can impact it. Knowing what could happen and having a plan for all possibilities will be the difference between delivering stellar long-term results and having a lot of your growth from previous years wiped away forever.

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