Inflation Risks Are Flaring. Protect Yourself!

Description

Across the world, governments have unleashed an historic amount of cash to stem the tide of economic chaos. A flood of freshly printed currency could trigger an issue investors haven't had to deal with for decades: [inflation.]

Printing money

As commercial activity remains suspended and unemployment hits a record-high, governments have launched stimulus programs to support citizens.

Canada's COVID-relaed stimulus packages have been some of the most generous. The federal government's emergency stimulus plans for workers, businesses, seniors and homeowners amounts to $202 billion. That's roughly under 10% of the pre-crisis economy. And there could be more stimulus ahead, if the economy doesn't recover soon.

However, the Canadian government was already running a fiscal deficit before the crisis erupted. In other words, it was spending more money than it generated through taxes. This gap was plugged by the Bank of Canada, which minted new currency to pay for government spending.

Now that government spending has accelerated and tax receipts are likely to decline, the Bank of Canada needs to print more than ever before. This flood of cash could lower the value of the Canadian dollar. The local currency has already lost 5% of its value since February. If it weakens further, the average Canadian's purchasing power will decline as well.

Inflation impact

Warren Buffett once described inflation as a "silent tax" on investors. Inflation gradually erodes an investor's purchasing power over time, offsetting any gains from savvy investments.

For example, an annual inflation rate of 3% could cut the real purchasing power of a dollar in half within 24 years. In other words, you could invest $10,000 today and turn it into $20,000 by retirement and see no difference in your actual wealth.

This is the risk many experts see on the horizon now. Debt-fueled government stimulus could accelerate inflation over the next few years.

How to avoid the risk

When currency loses its value, investors tend to turn to the ultimate safe haven: gold. The precious metal is widely regarded as a hedge against inflation. The value of an ounce of gold should appreciate if the Canadian dollar depreciates over time. In fact, gold's value should remain stable against all major currencies, including the U.S. dollar.

Over the past two months, the value of gold has surged 18.6%. Each ounce of the yellow metal is now worth US$1,750 (C$2,430). If you're worried about inflation over the next few months or years, dedicating a portion of your portfolio to gold could help you minimize the damage. That's what billionaire hedge fund managers like Ray Dalio seem to be doing.

An exchange-traded fund, such as the **iShares S&P/TSX Global Gold Index Fund**, is a convenient option. However, you could also bet on gold mining giant **Barrick Gold** for similar exposure.

Bottom line

The Canadian government's historic stimulus measures are certainly necessary, but they could also be inflationary. By printing too much currency, the Canadian dollar could lose its value over time. Investors worried about inflation should consider adding gold to their portfolio to buffer the impact.

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