TFSA Investors: Worried About Inflation? Here's How You Can Protect Yourself

Description

Canadians who are smart with their money are always looking for ways to use their investments to secure a better financial future. The particularly risk-averse Canadian will look towards secure investments that pose low downside risk to capital. Bonds and other fixed-income investments offer a certain level of security compared to stocks that tend to be volatile assets — and pay a steady income.

However, the problem with fixed-income assets is that they pay you the same revenue over a long time without adjusting for inflation. But Real Return Bonds (RRBs) allow you to enjoy a growing income that can keep pace with inflation.

I will discuss the benefits of RRBs, their potential, and the downside they pose if you allocate funds to the assets.

The benefits of RRBs

RRBs present the option of helping your capital keep up with inflation. With a typical fixed-income asset, if your annual returns are 2%, you keep receiving the amount without fail. However, if the inflation rate is 5%, you are constantly losing money in terms of purchasing power. Inflation is a bond investor's enemy.

RRBs have the unique quality of growing and increasing interest payments made to you with rising inflation. This aspect helps your capital grow based on inflation rates and preserves your purchasing power. The adjustments to the rates occur over time throughout the lifetime of the bond. By the time the bond matures, the principal amount you receive is also inflation adjusted to the amount you originally invested.

The downside of RRBs

There are two downsides to owning an RRB. If you purchase and hold onto an RRB and the rate of inflation ever falls, the inflation adjustment would mean you would have been better off investing in a regular bond.

The second issue is that most RRBs come with long maturities. If the interest rates rise substantially before the securities mature, the bond's value in the open market can go down. It happens because bond prices and interest rates move in opposite directions to each other.

There are few issuers of RRBs in the Canadian market, and the lengthy duration can potentially increase investors' risk.

Risk-averse securities

Investors looking to park their funds in assets that can protect the capital and keep up with inflation might want to consider another asset class: dividend stocks.

Stocks typically have a higher risk of volatility than bonds, but reliable companies that can continue producing income through harsh economic environments can provide shareholders with their returns without fail. It is a matter of choosing the right companies from risk-averse industries.

To this end, **Fortis** (TSX:FTS)(NYSE:FTS) could be an ideal option for investors who want to protect their capital and keep up with inflation. Fortis is a defensive gem on the Canadian stock market. The utility company provides investors with extremely stable earnings and cash flow growth over extended periods.

Most of Fortis's revenue is regulated and comes through long-term contracts. It enjoys a small but predictable earnings growth over time. Typically, its dividend yield fluctuates between 3.5% and 4%, and it is proving to be one of the best Canadian dividend stocks. The company's excellent dividend growth for almost five decades is a testament to that.

Fortis also keeps growing in size, and its dividend increases have been in the mid- to high single-digit range during the toughest of times. Buying and holding Fortis stock in your Tax-Free Savings Account (TFSA) allows you to leverage the capital gains and reliable dividends for growing your wealth without worrying about inflation leaving you behind.

Foolish takeaway

RRBs certainly can present a better option than fixed-income for risk-averse investors who want their capital growth to keep pace with inflation. However, there can be some downside risks to owning RRBs. While Fortis is a stock, it is an asset that enjoys insulation from the broader market movement because of the nature of the underlying company's service.

I think it could be wise to consider adding Fortis stock to your portfolio in a TFSA.

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