U.S. Inflation Could Be the Next Big Risk to Stock Markets

Description

After the Federal Open Market Committee (FOMC) meeting on March 17, 2021, U.S. Federal Reserve Chairman Jerome Powell said they will keep policy loose. The central bank would leave interest rates at near-zero levels, at least through 2024.

However, a headstrong wave is coming to the U.S. if the Federal Reserve doesn't play its cards right. The U.S. policymakers expect inflation to jump to 2.4% in 2021, above their 2% target. Higher inflation could shake stock markets if it happens.

Inflation is an issue

Chairman Powell said the inflation surge would be temporary and not enough to compel the Feds to change its benchmark overnight interest rate. The officials voted unanimously to maintain a target range of 0% to 0.25%. Keeping the near-zero rate ensures the economic wounds from the pandemic will heal fully.

Benjamin Tal, the deputy chief economist of **CIBC** World Markets, said, "We cannot say 100 percent that inflation is not an issue." Tal thinks the Fed is playing a very interesting game. It might be avoiding to discuss inflation because it could spook the bond and stock markets. Others believe the Feds' approach is a calculated gamble.

The **S&P 500 Index and Dow Jones Industrial Average** closing at record highs following the FOMC policy statement. Powell said, "We are clearly on a good path. But we are not done, and I would hate to see us take our eye off the ball."

Optimistic outlook

Powell also notes that the FOMC leans toward no interest rate increase until 2024. He also noted the "strong bulk" of the policy-setting Federal Open Market Committee anticipates no interest rate increase until 2024. Similarly, the Feds will not scale back the purchase of Treasury bonds and mortgagebacked securities because it props up the economy.

The U.S. Fed officials expect economic growth to be around 3.3% in 2022 and 2.2% in 2023. Its previous estimated long-term potential growth was 1.8%. Meanwhile, the group expects gross domestic product (GDP) growth in 2021. The encouraging forecast stems from the massive federal fiscal stimulus and optimism around the successful coronavirus vaccinations.

Hedge against inflation

The whole point of investing is to be able to cope with the rising standard of living. Thus, a high inflation rate is a concern of investors. Fortunately, some assets are excellent hedges during elevated inflationary environments.

A dividend stock in the **TSX** can beat inflation over the long-term. **Fortis** (TSX:FTS)(NYSE:FTS) is a practical choice for risk-averse investors. Apart from the bond-like features, the utility stock is recession-resistant. Over the last 20 years, the stock's total return is 1,116.47% (13.29% CAGR).

Thus far, in 2021, Fortis is holding steady with its 7.03% year-to-date gain. At $55.11 per share, the dividend yield is 3.69%. The payout ratio is 74.52%. A company whose utility assets are virtually 100% regulated should give you the confidence to invest.

The best part is that Fortis expects long-term growth in rate base to support earnings and dividend growth. Management targets an average annual dividend growth of 6% through 2025.

Impact on stocks

Market observers hope that the no-policy response to the temporary rise in inflation by the U.S. Feds is correct. Investors worry about rising inflation because stocks are generally more volatile during high inflationary periods. Investors must find suitable hedges against inflation.

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