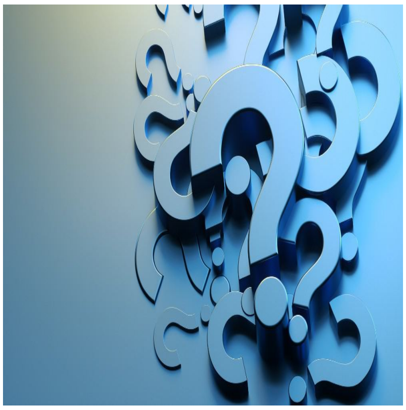

Inflation: How Should Canadians Invest in Uncharted Waters?

Description

2021 has been all about the cyclical, reopening, and value trades, as growthy tech took a backseat, thanks in part to the return of inflation.

While the horrific pandemic has accelerated the adoption of next-generational technologies, including those pushing the digital transformation, one had to think that tech and growth would be due for a breather at some point. They melted up in 2020, after all, blasting past all-time highs at an absurd rate.

Market prices of the fastest growers like **Shopify** may have exceeded even the most optimistic projections of their intrinsic value ranges. That's a major reason why I'd warned investors of a severe growth-to-value rotation back in January 2021. Not only were tech and growth valuations getting out of hand, but I thought rate-hike jitters would be the natural next step, as stimulus was surely to pave the way for some nasty inflation.

The recent U.S. consumer price numbers were much higher than expected at 4.2%. But the spike really shouldn't have been a surprise, given the unprecedented magnitude of stimulus injected into the economy last year.

With the tides turned, beginner investors reluctant to take a profit are now finding themselves stuck in the penalty box. The Nasdaq 100 suffered from an isolated correction. Tech stocks with higher multiples and distant profitability prospects crashed, as concerns about inflation and the prospect of higher rates caused some folks to look to the value names that may have been left behind during last year's epic rally.

Considerable inflation finally rears its ugly head

The technological acceleration has already been baked in. Now, all eyes are set on how the economy copes with inflation, as the economy looks to take its recovery to the next level. And with that comes the risk of overheating and the need for interest rate hikes.

Like it or not, growth stocks will probably trade hand in hand with the bond market.

Predicting short-term moves in rates is a bad idea, though. Nobody really knows if they're headed much higher, lower, or if they're going to stabilize.

As such, I think it's only prudent to be ready for all scenarios. I think one of the biggest risks in markets right now is a more hawkish pivot from the U.S. Fed. Such a surprising move could send rates surging and tech stocks plunging even further into the abyss.

Sure, the Fed may not be thinking about raising rates anytime soon. But if 3-4% inflation lingers for longer, the pressure will be on and the greater the chance, I believe, that the Fed will drop a bombshell.

Overweight in growth stocks? Try diluting your exposure with a name like Fortis

For investors, that means bracing for increased volatility with speculative technology holdings. Many such names have already sustained quite a bit of damage, so I wouldn't overreact to the high-impact, low-probability scenario that sees the Fed goes against their past dovish commentary. If you are, however, overweight in names like Shopify, there's no shame in having a preference for profitable utility stocks like **Fortis** (TSX:FTS)(NYSE:FTS), which can act as "shocks" for your portfolio once the road gets rougher.

Fortis is a bond proxy with a 3.7% yield that's slated to grow at a 5% annualized rate. It's pretty boring, but you'd be glad you held such a name if ever negative surprises like rampant inflation were to propel the markets into a steep correction.

In any case, I view Fortis as a name that can help dilute your most at-risk holdings in today's uncertain environment. By opting to dilute and not sell your at-risk holdings, you won't be kicking yourself if it turns out that inflation is, in fact, transitory and the Fed continues as planned with its accommodative policy.

Bottom line

Remember, timing the bond and stock markets is a losing proposition. Stay invested and be mindful of risks you'll bear. With the return of inflation, investors face risk from all sides.

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