A Top REIT to Defend Against Inflation

Description

Inflation can be a tough beast that's hard to tame. Many beginner investors haven't had to grapple with it, given problematic inflation has laid dormant for decades.

Market participants are divided into two camps these days: those who believe the recent bout of +3% inflation will be transitory, and those bracing themselves for inflation to hit a "new normal." Investors don't need to pick a side, though. In fact, I'd argue it's far wiser to prepare for both scenarios.

Recent inflation headlines can be pretty scary. And while an inflationary environment can take a toll on stock returns, with a concentration of the damage done to growth stocks, I'd discourage investors from trying to predict what inflation or rates will do next. Unexpected inflation poses a major risk to stock investors right now. But if it turns out the Fed was right, and inflation is transitory (there's no way to know today), a big chunk of today's beaten-down growth stocks may prove to be severely undervalued.

The best way to play it? Position your portfolio to hold up, regardless of the nature of inflation. Find the perfect mix of growth and inflation-resilient value, and you'll be in a spot to smoothly navigate a market environment that's unfamiliar to us all.

REITs are a great asset class for this rocky environment

REITs (real estate investment trusts) are a great place to hide relative to growth stocks if you're worried about the insidious impact of higher inflation. While REITs aren't the best asset class to be in when there's upward pressure on prices, it's certainly not a space that will feel a brunt of the damage, given its limited correlation to the broader equity markets.

Compared to office, or industrial REITs, which tend to have longer leases, residential REITs have more flexibility to increase rent in reaction to upward pricing pressures. When preparing for an inflationary environment, it can pay dividends to insist on profits in the here and now, rather than settling for massive profits way out into the future.

REITs are required to pay out an overwhelming chunk (90% of taxable income) to their shareholders in the form of a distribution, with a minimal amount to be reinvested in growth projects. More profits over the near term and less rate-induced volatility make REITs a great place to be for those looking to better prepare for the return of inflation.

CAPREIT: The perfect REIT to fight inflation?

Canadian Apartment Properties (TSX:CAR.UN), or CAPREIT for short, is the gold standard of residential REITs. The REIT has a bountiful 2.5% yield that's well positioned to grow over time. As a "growth REIT," CAPREIT is a rare breed, indeed.

Investment legend Philip Fisher, the author of *Common Stocks and Uncommon Profits*, would likely describe CAPREIT as a company that's both "fortunate and able."

CAPREIT is "fortunate and able," because of its positioning in some of the hottest real estate markets out there (Vancouver and Toronto) and management's capabilities to capitalize on the opportunity at hand. Given CAPREIT's favourable positioning in some of the hottest real estate markets on the planet, the REIT has incredible pricing power. CAPREIT can easily increase rents on annual leases coming due. With few alternatives, many renters will either be forced to pay up or find another apartment — a daunting task in a place like Vancouver or Toronto.

Foolish takeaway

REITs may not be cheering for higher inflation and rates, but they're better positioned than most equities to hold their own if an inflation storm does happen. A residential REIT with pricing power like CAPREIT may be one of the better ways to hedge your bets if you're overexposed to inflation-sensitive securities, most notably high-multiple tech stocks.

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