TFSA Investors: How to Invest Amid 2021 Inflation Jitters

Description

If you're a beginner TFSA investor who's sitting on a considerable sum of cash in your TFSA (Tax-Free Savings Account), please don't spend too much time waiting around for the next market crash or correction. As you're probably aware, the market is an unpredictable beast. It acts in strange ways. And at times, it can even act irrationally.

For instance, take 2020, a terrible year that saw the insidious coronavirus spread rapidly across the globe, sending the world economy into lockdown. It was one of the worst years on record. Yet, the stock market actually ended up higher, thanks in part to major contributions by pandemic-resilient tech stocks. If 2020, a horrible year for humans, can be a good year for the stock market, a better year (like 2018) can be bad for stock returns.

In 2018, the Trump administration cut corporate tax rates — a major boost for corporate America. Yet the year ended up in the red, thanks in part to a hawkish Federal Reserve, who was hitting the economy with rate hikes that investors clearly were not prepared for.

2021: Good year for the economy, bad year for the markets?

In many ways, 2021 seems to "rhyme" with 2018. The economy is recovering in a big way. Employment is healing, and consumer spending could fuel an environment that some have referred to as "the Roaring '20s." Once again, the Fed has tough choices to make, as it looks to cool down the economy without halting the employment recovery in its tracks.

It's a tough situation, but with inflation genie now out of the bottle, I think the Fed will have to reluctantly raise rates. Inflation jitters and rate hike fears have mostly been shrugged off by growth investors like ARK Invest's Cathie Wood, who believes growth stocks may soon be in a spot to bounce back after the recent "broadening out" of the market.

How should TFSA investors invest amid inflation?

While I don't think TFSA investors should take an extreme stance by betting on speculative growth stocks with a big chunk of their portfolios, I do think it's a terrible idea to stay in cash, as you fear what most others already fear.

2021 got off to a good start, but sentiment is a bit uneasy over the recent uptick in inflation and the possibility of having to fight the Fed, as they hike rates and hurt asset prices. Sure, rate hikes could hurt equity prices, but with higher inflation, the penalty for saving has been increased.

As such, TFSA investors should find the right balance between holding cash and risk-free securities like GICs (Guaranteed Investment Certificates) and "risky" securities like equities. For the cautious, I'm a big fan of owning a bond proxy utility like **Fortis**. While there are no guarantees in the world of equities, I think Fortis and its growing dividend are about as close to a "sure thing" as you're going to get. And at current valuations, I think TFSA investors should stash the name in their portfolios, as they prepare for pressure to come from all sides.

The bottom line for TFSA investors

Nobody knows what the Fed's next move will be. I think they'll increase rates but will do so very gradually and will give the market enough notice, so it won't spark another 2018-style market crash. I think chairman Jerome Powell learned a lesson from the 2018 year-end plunge and don't think investors should wait for such a dip, as it may not happen for years, leaving TFSA savers vulnerable to the insidious effects of inflation.

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Date
2025/07/28
Date Created
2021/06/09
Author
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