Inflation Alert! Hedge Your Portfolio Against Inflation With the 3 Best TSX Stocks

Description

Economists and investment strategists are divided over inflation risks. On the one hand, investment strategists say inflation is a time bomb that investors are underestimating. On the other hand, economists say that rising inflation is temporary and will correct as things normalize. But both agree on one thing: that inflation will spike in the second half of the year as economies reopen. And rising inflation is not good news for your portfolio, as it reduces your real return.

Inflation and taxes can eat up your investment returns

Inflation is an increase in the price of goods and services a consumer pays. The impact of inflation is high when the prices of essentials like energy, food, and shelter increase. If inflation rises at a faster rate than your investment return, you stand to lose as your purchasing power falls.

Something like this happened in 1980 in the United States. The benchmark 10-year Treasury bond reached its highest-ever average yield of 11.43%, and the average return of the S&P 500 index was roughly 10%. In isolation, these returns look good. But after adjusting for inflation, which was 13.5%, the return is negative. And this is before taxes. The real return after inflation and tax reduced purchasing power. This means people’s investment lost value.

This raises a question as to how to protect or hedge your returns from the risk of inflation.

Hedging the inflation risk

Not all sectors are negatively impacted by inflation. According to Statistic Canada, the Consumer Price Index (CPI) rose 3.4% in April 2021, because its base year inflation was low. In April 2020, headline CPI stood at -0.2%, as the pandemic-induced lockdown curbed spending on things like recreation and transportation. Inflation is expected to increase, as the economy reopens and these companies see pent-up demand.

To hedge your portfolio against inflation, invest in sectors that will see pent-up demand, like oil, electricity, and real estate. Here are three stocks that will surge with rising inflation.

Suncor Energy

Suncor Energy (TSX:SU)(NYSE:SU) stock has surged 43% year to date as oil prices surged. As the economy reopens and people start travelling again, gasoline and jet fuel demand are rising. And this demand increase is sharp and is reflecting in prices. Last year, many oil companies, including Suncor, halted oil production temporarily, as there was no place to store inventory. The Organization of the Petroleum Exporting Countries (OPEC) is gradually increasing the oil supply after considering the uncertain nature of the pandemic.

The demand environment is favourable for oil prices to continue growing. If inflation increases, the oil price will increase, and so will Suncor's share price.

A 43% surge in an oil stock in five months is difficult to see. Generally, growth stocks give this kind of appreciation. There is still a 37% upside potential if the stock is to return to the pre-pandemic level. This rally plus the 2.74% dividend yield will take care of the inflation risk.

RioCan REIT

Real estate is another sector that will benefit from rising prices. **RioCan REIT** (TSX:REI.UN) is Canada's second-largest retail REIT, and its stock has not yet recovered completely. It has increased the rent in the renewal contracts and new occupancy. The stock has surged 32.6% year to date and has a 4.4% dividend yield. It has a 22% upside on its road to pre-pandemic stock price. Its competitor **SmartCentres REIT** has already recovered significantly.

RioCan's recovery got delayed because it halved its dividend during the pandemic. But this also opens an opportunity for dividend growth once business normalizes.

Canadian Utilities

Lastly, growing energy prices will benefit **Canadian Utilities** (TSX:CU). It generates, transmits, and distributes electricity and natural gas to two million customers in four countries: Canada, Australia, Chile, and Mexico. It derives about 95% of its earnings from the rate-regulated utility assets that ensure steady cash flow. However, its 2020 net income fell 55%, as the pandemic-induced lockdown closed offices, shopping malls, restaurants, and stores, reducing energy consumption.

The reopening of the economy will bring a steep upside, and it is already reflecting in its stock price, which has surged 16% year to date.

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TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. TSX:CU (Canadian Utilities Limited)
3. TSX:REI.UN (RioCan Real Estate Investment Trust)
4. TSX:SU (Suncor Energy Inc.)

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