Worried About High Inflation? Protect Your Portfolio With This Top Bank Stock

Description

According to the Bank of Canada (BoC), the average inflation rate (as measured by the consumer price index, or CPI) for 2021 hit a whopping 4.4% for goods and 2.1% for services. The quantitative easing during the COVID-19 pandemic, coupled with a resurgent economy and disruptions in supply chains have trickled down into higher costs for businesses and consumers.

You're probably thinking, "This sounds scary and all, but what does it mean for my stock portfolio?" In short, it's not great. If inflation gets out of control, the BoC may try and raise the policy interest rate to slow down the economy. This makes the cost of borrowing higher for both businesses and consumers, which can slow down growth. The effects of this can trickle into the stock market, causing growth stocks to lose value.

What can I do?

Inflation and rising interest rates don't necessarily have to spell doom for your portfolio. Certain sectors, like commodities and consumer essentials can actually benefit from inflation, being able to raise their prices and generate more revenue. As well, the banking sector tends to do great — as the BoC policy rate increases, so does the rate the bank charges consumers and businesses. This results in higher interest rates on loans, mortgages, lines of credit, etc.

For this reason, some banks are able to maintain their revenue and margins during inflationary conditions, as they can pass the costs onto their end users. This generates more value for them, leading to a potential increase in the share price. Therefore, buying and holding a well-established, financially sound bank with a history of outperformance and solid fundamentals could be a good play against inflation.

The best bank stock for this role

Royal Bank of Canada (TSX:RY)(NYSE:RY) is the largest bank in Canada by market capitalization and the second-largest company in the **S&P/TSX Composite Index** by revenue and market capitalization. The company has consistently delivered outstanding earnings and profits year over year, weathered the 2008 Great Financial Crisis, and posted over two decades of consistent dividend payouts and increases, which currently sits at a 3.33% yield.

Royal Bank's stock has some great fundamentals to back these accomplishments. Valuation wise, it currently trades at a P/E of 11.85, forward P/E of 14.74, P/S of 6.62, P/B of 2.03, and a P/FCF of 3.55, all of which are favourable when compared to its biggest competitors in the sector. The company boasts some excellent financial ratios, with a long-term debt-to-equity ratio of just 0.13, operating margin of 68.90%, profit margin of 56.10%, and an ROE of 18.10%.

The Foolish takeaway

The BoC has been optimistic about its inflation forecast, stating that they expect it to remain high for the first half of 2022, before easing back to their target of 2% in the second half. For now, the BoC has decided to maintain the policy interest rate at the current 0.25% and reaffirmed their commitment to hold it there until the economy has fully recovered.

Despite this, I think buying Royal Bank stock would be a good cautionary play in case things don't pan out the way the BoC forecasts. The stock is currently trading at $130.18 — or just 3.26% lower than its 52-week average of $134.23. However, Royal Bank is solid enough that I wouldn't advocate for trying to time a better entry price. From my point of view, this is an excellent stock that should be a consistent buy and hold, whether as a hedge against inflation or as solid, large-cap Dividend Aristocrat.

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