Buy These 2 REITs to Protect Against Stagflation

Description

Stagflation. What is it? It sounds scary right? Essentially, it is combination of stagnant economic growth plus higher than forecasted inflation. Right now, it is potentially on the horizon for both Canadian and U.S. investors.

While economic growth shows signs of slowing as the U.S. Federal Reserve tapers its stimulus and hikes interest rates, inflation remains persistently elevated and un-transitory thanks to a combination of supply chain disruptions, global economic sanctions, and sky-high energy costs.

A stagflationary environment wreaks havoc on most conventional investment portfolios, with both stocks and bonds expected to deliver muted or negative returns under such conditions. Investors seeking returns in a stagflationary environment have to consider alternatives like commodities, precious metals, or real estate.

Why invest in real estate?

For the last option, a good pick for your investment portfolio are real estate investment trusts (REITs). As a pool of real estate assets trading on a stock exchange, REITs offer liquidity, monthly income, potential for capital growth, and exposure to real assets without the need to purchase property.

You can think of REITs as corporations that act like a mutual fund for real estate holdings. They pool the capital of numerous investors, invest in real estate, and pay a distribution through the underlying rental/lease income generated. Consider it like being a landlord and collecting rent, but without the hassle.

Shares of REITs trade on stock exchanges like any other stock, making it easy to buy and sell when you want. REITs can be held like any other qualified investment in a TFSA and RRSP, allowing for tax-free or tax-deferred distributions and capital gains. This makes them an excellent diversifier for most portfolios.

Which REITs are best for stagflation?

REITs can invest in different types of property holdings, such as residential, industrial, office, and retail. Different sectors have varying levels of distribution yield and risk, so you can pick and choose to match your needs.

Good picks for a stagflationary environment would be industrial and residential REITs. These offer a hedge against inflation by passing through higher costs to their tenants through rent increases. Rising property prices (especially in Canada) also outpaces inflation significantly, which raises the value of REITs.

For a residential pick, consider **Canadian Apartment Properties REIT** (TSX:CAR.UN). CAR.UN owns more than 57,000 suites, including townhomes and manufactured housing sites, in Canada. CAR.UN pays a distribution yield of 2.67% ($1.45 per share), and has a sustainable payout ratio of 17.54%.

For an industrial pick, consider **Granite REIT** (TSX:GRT.UN). It owns over 108 logistics, warehouse, and industrial properties in North America and Europe, representing approximately 45.3 million square feet of leasable area. GRT.UN pays a distribution yield of 3.27 ($3.1 per share), and has a sustainable payout ratio of 15.09%.

The Foolish takeaway

REITs are uniquely positioned to potentially benefit from an inflationary environment. If inflation becomes stagflation, their income potential provides investors with a source of returns in an otherwise unpredictable market. A small allocation to REITs in your portfolio can therefore provide great diversification benefits.

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