Inflation Surged to 7.7%: Protect Your TFSA

Description

Canada's inflation rate surged to 7.7% in May — the highest level since 1983. The rate was also higher than the previous month's rate of 6.8%. This economic trend is worrying. Here's how the pace of inflation impacts investors and what you can do to protect your wealth.

Impact of inflation

Rising inflation causes a broad range of impacts. For one, it erodes purchasing power. If the annual inflation rate in 2022 is roughly 7%, you need a 7% return just to sustain your level of wealth. To create more wealth, you need a higher return. That's extremely difficult in this environment.

Most stocks offer 2-3% in dividends. Growth stocks have *lost value* instead of generating the +7% returns required. These companies also face the brunt of inflation. If their cost of production and wages rise, profit margins are compressed. That means some companies could see a dip in earnings ahead.

What comes next?

It's up to the Bank of Canada to control inflation now. It's done so in the past by raising interest rates. This time, rate hikes will have to be aggressive and swift to contain the problem.

The Bank of Canada's policy rate has surged from 0.25% in January to 1.5% today. Experts expect the rate to rise above 3% over time. At that rate, consumers and businesses can borrow and spend less money, which reduces demand and cools inflation.

Unfortunately, cooling demand means less growth. Investors need to take a closer look at their portfolios and reallocate funds to prepare for this.

Protect your wealth

Nearly all investors will face some pain ahead. But you can mitigate the pain by reducing expenses, focusing on essential businesses with pricing power and low debt.

One way to reduce expenses on your portfolio is to maximize your Tax-Free Savings Account (TFSA). Reducing the cost of taxes on your investments is probably the easiest way to boost performance over time.

The next step is to seek out an essential business like **Fortis** (TSX:FTS)(NYSE:FTS). The utility provider could serve as an inflation hedge. That's because consumers can't cut back on electricity, even when costs are rising. Fortis has immense pricing power.

This pricing power is reflected in the stock's dividend yield of 3.4%. Fortis management expects this dividend payout to rise 5-6% every year for the next few years. That makes this an ideal stock for investors worried about inflation's impact on their passive income.

Another appealing factor is the stock's stability. Taking a look back at previous years, Fortis stock has been far less volatile than most tech and growth stocks. In fact, it's more stable than other industrial and oil stocks too. It rarely dips more than double-digit percentages.

Adding some exposure to Fortis in your TFSA could help you prepare for the inflationary pressure ahead.

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