The Top 3 ETFs to Beat Inflation

Description

Inflation has come roaring back into our lives after four decades of hibernation. In May, Canada's consumer price index surged 7.7% — the fastest pace since 1983.

For most investors, this is a new phenomenon, which makes it difficult to deal with. Nevertheless, historical evidence suggests some assets do better than others during such cycles. Here are the top three ETFs that could help you beat inflation this year.

Energy ETF

The ongoing wave of inflation is led by fuel. Oil and natural gas prices were surging even before Russia invaded Ukraine. Now, they've hit fresh highs. This is bad for the economy but excellent for oil and gas producers. Canada's oil patch is seeing surplus cash flows now.

iShares S&P/TSX Capped Energy Index ETF (TSX:XEG) gives investors exposure to this trend. The ETF is up a whopping 112% over the past year. This month it's taken a small dip, but if oil prices recover the ETF could surge back quickly.

XEG's holdings include 28 of the largest oil and gas producers in Canada. The average dividend yield of this portfolio was just 1.3% on a trailing basis, but I expect this to rise higher in the months ahead. Meanwhile, the portfolio is trading at just 11 times earnings per unit. That means it's undervalued, even if oil prices don't rise from current levels.

XEG could be an ideal inflation hedge for investors worried about the rising cost of fuel.

Agriculture ETF

Fuel isn't the only driver of inflation. Food costs are rising too. Bad weather and supply chain issues are somewhat responsible, but the lack of fertilizer from Ukraine and Russia is magnifying the problem.

iShares Global Agriculture Index ETF (TSX:COW) could give investors exposure to agricultural companies and food producers. The ETF is up 32% over the past year, which is far higher than the headline inflation rate.

COW's top holdings include packaged meat producers, fertilizer makers, agricultural chemical companies, and farm equipment suppliers. All these businesses face tailwinds from the ongoing food shortage. Adding exposure to this sector could be a savvy way to hedge inflation's impact on your portfolio.

U.S. TIPs

The purest inflation hedge is the United States Treasury Inflation-Protected Securities, or TIPS. These are a basket of government bonds that are linked to the official inflation rate. In other words, the yield on these bonds matches the inflation rate.

iShares 0-5 Year TIPS Bond Index ETF (CAD-Hedged) (TSX:XSTH) offers Canadian investors a convenient way to bet on these special treasuries.

Unfortunately, these are U.S. instruments, which means the yield is linked to our neighbor's inflation rate. For instance, the current distribution yield of XSTH is 7.8% — roughly in line with U.S. inflation. If Canada's inflation rate races ahead, this ETF might not deliver a perfect hedge.

Nevertheless, this ETF offers a safe haven for investors looking for places to park cash without losing purchasing power.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:COW (iShares Global Agriculture Index ETF)
2. TSX:XEG (iShares S&P/TSX Capped Energy Index ETF)

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