Stocks, Bonds, or Real Estate: What's the Best Way to Prepare for a Recession?

Description

Global growth is weakening. Consumers are cutting back on spending which is pushing companies to lay off workers. Unemployed workers, in turn, spend less, which creates a vicious cycle that could lead to a recession.

An economic downturn isn't set in stone, but the likelihood is steadily increasing. Investors need to prepare right away. But picking the right safe haven is tricky. Here's a look at which asset class could be safest.

Stocks

Canada's stock market is dominated by financial and energy companies. The top five holdings in the **iShares S&P/TSX 60 Index ETF** (TSX:XIU) are all banks and oil producers. On paper, these stocks look cheap.

The fund is trading at a price-to-earnings ratio of 14.77. However, that ratio could be deceptive. Earnings could drop in a recession. Consumers could default on the loans and mortgages banks have provided while demand for energy is tamed in a downturn. The fund could see some downward pressure if the economy dips.

It's also not a great option for passive income. XIU's dividend yield is just 2.8%. That's well below the rate of inflation. In fact, it's lower than the dividend rate on bonds.

Bonds

The Canada 5-Year Government Bond offers a 3.18% dividend yield. That's higher than the average dividend yield of the 60 largest companies in the country. Bear in mind that these government bonds are much less risky. The rate is fixed for five years and is backed by the Canadian government.

If you're looking for a higher yield, consider Guaranteed Investment Certificates (GICs). **Equitable Bank**

(TSX:EQB) offers 4.6% annual interest rates for GICs ranging from five years to 10 years. That's a fixed, guaranteed return for a decade that is likely to be much higher than the dividend yield on stocks. In fact, it could also be higher than the net rental income on investment properties.

Real estate

The rental yield in Canada is already unimpressive. The average household income simply isn't high enough to compensate for overvalued residential real estate. This is why real estate investment trusts like **Canadian Apartment Properties REIT** (TSX:CAR.UN) offer unattractive dividend yields. CAPREIT's current yield is just 3.3%. That's lower than the government bond and GICs discussed above.

Rents are also subject to change. If we face a recession and higher unemployment, landlords like CAPREIT could see higher occupancy levels and lower returns. REITs have cut dividends during previous recessions, so investors should take the current dividend yields with a grain of salt.

Bottom line

Investing during recessions is difficult. Investors must weigh potential returns against possible risks. At the moment, the safest risk/reward balance seems to be in bonds. GICs and government treasuries offer fixed returns for multiple years that are above dividend yields. Investors should consider parking some cash in these instruments as a safe haven.

CATEGORY

1. Investing

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