Surprise 100 Basis Point Rate Hike: Where Should You Invest Now?

Description

The official inflation reading for June 2022 will come out this week and the Bank of Canada (BoC) expects the rate to be a little above 8%. Governor Tiff Macklem told the Canadian Federation of Independent Business that he won't be surprised to see a high consumer price index (CPI) because oil prices were very high last month.

On July 13, 2022, the central bank shocked the market with a full percentage point rate hike, not 75 basis points as most economists predicted, raising the lending rate to 2.5%. Data shows that in 2022, the BoC is one of 30 central banks that have increased rates by 1% or more. Mark Carpani, fixed income head at Ridgewood Capital Asset Management, said going above market expectations was a bold but the right call.

Finance Minister Chrystia Freeland, also Canada's Deputy Prime Minister, adds that the federal government wasn't pouring fuel on the flames through its budget, and by focusing on some inflation drivers like labor and housing. Meanwhile, the impact of multiple rate hikes, including the latest supersized increase, is impacting negatively on the **TSX**.

While the index advanced slightly on Friday (+0.36%), it closed below 19,000 in each of the last five trading sessions. The TSX has lost 6.21% in one month due to runaway inflation and a potential recession. If energy stocks are weakening, where else can you invest?

Resilient sector

Gold is a logical option when volatility is high, although gold stocks haven't displayed resiliency thus far in 2022. Utilities was the only sector that gained in five days. Some market analysts say this sector typically declines when interest rates are rising but it isn't happening in the current cycle.

Shahriar Pourreza, the managing director at Guggenheim Securities LLC, said utilities are becoming a higher growth sector that is just as stable amid extremely pronounced interest in the industry. He said he has covered utility stocks since 2001 but has never seen the space this fundamentally strong. Pourereza adds, "You could even make an argument that the sector could be positively correlated to interest rates."

Hedges against inflation

On the TSX, the stocks that stand out amid the market uncertainty are **Canadian Utilities** (TSX:CU) and its parent company **ATCO Ltd.** (TSX:ACO.X). You could buy either one to hedge against inflation and prepare for a recession.

Canadian Utilities is the best-in-class choice because the stock is Canada's only dividend king. The $10.84 billion diversified global energy infrastructure company has earned the distinction because it has raised its dividends for 50 consecutive years. At $40.32 per share, current investors enjoy a 12.56% year-to-date gain on top of a generous 4.41% dividend.

ATCO, CU's parent company, is equally stable with its 8.87% year-to-date gain. If you invest today, the dividend yield is an attractive 4.05%. This $5.19 billion company invests in the essential services of Structures & Logistics across nearly all industries or sectors.

In Q1 2022, CU and ATCO reported adjusted earnings growth of 14.7% and 12.6%, respectively, versus Q1 2021. The four core business segments that contribute to revenues are Energy Infrastructure, Retail Energy, Transportation, and Commercial Real Estate.

Necessary move

The Bank of Canada has pre-empted June's inflation reading with its surprise 100-basis point hike. The central bank believes that front-loading interest rate increases now will limit economic damage.

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