



PORTFOLIO STRATEGY

# Seven ETFs to fight inflation’s predation in your investment portfolio

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If you’re under the age of 60, you may never have faced a question that all investors must answer right away.

Is inflation a short-term annoyance, or a longer-term problem? For now, inflation is right up in our faces. The May inflation rate in Canada came in at 3.6 per cent, up from a 10-year average of 1.6 per cent, while U.S. inflation hit 5.4 per cent in June.

Prices are rising faster than many investors have seen in their lives, and investments that feed off inflation are gaining ground. Interested in adding some of this inflation-fighting capability to your portfolio? To highlight what’s available, seven ETF companies were asked to highlight a single fund in their lineup for investors seeking inflation protection. Here’s what they came up with (see chart for additional details):

## The inflation-fighters

*Seven companies offering exchange-traded funds were asked to highlight their top fund choice for investors seeking inflation protection. Here are their picks*

FUND	TICKER	ASSETS (\$M) (JULY 8)	MER (%) (JULY 8)	PRICE (\$) (JULY 8)	1-YR % RTN TO JUNE 30
<b>BMO Equal Weight Oil &amp; Gas Index ETF</b>	<b><u>ZEO-T</u></b>	190	0.61	42.05	59.9

FUND	TICKER	ASSETS (\$M) (JULY 8)	MER (%) (JULY 8)	PRICE (\$) (JULY 8)	1-YR % RTN TO JUNE 30
<b>CI Gold Bullion Fund C\$ Hedged Series</b>	<a href="#"><u>VALT-T</u></a>	540	0.16*	22.91	n/a
<b>Horizons Active Preferred Share ETF</b>	<a href="#"><u>HPR-T</u></a>	1,753	0.64	9.48	45.8
<b>Invesco Nasdaq 100 Index ETF – CAD hedged</b>	<a href="#"><u>QQC-T</u></a>	2,213	0.2*	22.10	n/a
<b>iShares S&amp;P/TSX Global Base Metals Index ETF</b>	<a href="#"><u>XBM-T</u></a>	198	0.6	17.76	86.8
<b>Mackenzie US TIPS Index ETF (CAD- Hedged)</b>	<a href="#"><u>QTIP- NE</u></a>	589	0.18	110.13	6
<b>Vanguard Balanced ETF Portfolio</b>	<a href="#"><u>VBAL</u></a>	1,900	0.24	30.11	16.5

Source: Globeinvestor.com, ETF company websites

### ***BMO EQUAL WEIGHT OIL & GAS INDEX ETF (ZEO-T)***

Alfred Lee, investment strategist and portfolio manager at BMO Investments, said there's a twofold argument for holding ZEO right now. One is that commodities, oil and gas among them, generally do well at times when inflation is on the rise. The other is a global oil supply shortage.

Mr. Lee said U.S. oil rigs are running at production levels that are well below pre-COVID levels. "Once the economy opens up again, demand is going to come back a lot quicker than supply can," he said. "As oil prices go higher, that's going to be good for Canadian oil producers, who tend to be higher-cost producers."

ZEO holds equal positions in 10 large-capitalization TSX-listed energy companies, including producers like Suncor Energy Inc. (SU-T) and pipeline companies like

Enbridge Inc. (ENB-T). ZEO has soared in recent months, so inflation has to some extent been priced into these stocks. On the other hand, ZEO's three- and five-year annualized returns were still negative as of June 30. The Canadian energy sector was in a huge hole before the recent rebound.

### ***CI GOLD BULLION FUND C\$ HEDGED SERIES (VALT-T)***

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‘Periods where yields are low and inflation is on the rise have generally been advantageous for gold prices,’ says Nirujan Kanagasasingam, director of ETF strategy at CI Global Asset Management.

That pretty much nails the current financial market landscape. Bond yields are up this year, but the five-year Government of Canada bond still yields less than 1 per cent. Inflation, meanwhile, has pushed higher lately.

Gold has returned about 11 per cent in U.S. dollars on an average annual basis over the past 50 years, Mr. Kanagasasingam said. During periods when inflation was above 3 per cent, gold's average annual increase grew to 15 per cent.

The sweet spot for weighting gold in a portfolio is about 5 to 10 per cent, Mr. Kanagasasingam said. Historically, this level of exposure in a traditional portfolio, initially weighted 60 per cent to stocks and 40 per cent to bonds, has added to overall returns while tamping down risk.

### ***HORIZONS ACTIVE PREFERRED SHARE ETF (HPR)***

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‘When I look at inflation, I immediately think about what is this going to do to fixed income portfolios,’ said Mark Noble, executive vice-president of ETF strategy with Horizons ETFs. ‘The vast majority of Canadian investors are overweight on fixed income. We have the highest proportion of fixed income ETF ownership in the world, and it's not even close.’

Inflation is disruptive to fixed income because it drives bond prices lower – the benchmark FTSE Canada Universe Bond Index fell 3.5 per cent on a total return basis in the first half of 2021. One answer is to own preferred shares via a fund like the Horizons Active Preferred Share ETF (HPR). This fund holds rate reset preferred shares, which adjust their yields every five years to maintain a spread over the five-year Government of Canada bond.

Mr. Noble said preferred shares are not a substitute for fixed income because they're more volatile. But they do offer two things that bonds do not – higher yields as inflation and interest rates rise, and a better yield than bonds as well. HPR's yield was about 4.7 per cent in early July.

### ***INVESCO NASDAQ 100 INDEX ETF – CAD HEDGED (QQC-T)***

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Pat Chiefalo, head of ETFs in Canada for Invesco, has a straightforward suggestion for inflation-fighting. “Despite the meaningful moves in equities so far this year, with both the S&P/TSX Composite and S&P 500 indexes up about 16 per cent in price, we would continue to recommend equities for inflation protection,” he said by e-mail.

Mr. Chiefalo’s stock index of choice for inflation protection is the tech-heavy Nasdaq 100, which he describes as offering exposure to some of the most innovative and disruptive stocks in the world. Apple Inc., Microsoft Corp. and Amazon.com Inc. account for almost one-third of this ETF’s holdings.

QQC was listed for trading on May 10, so there are no performance numbers to look at. But the Nasdaq 100 index hedged to Canadian dollars made 43 per cent for the 12 months to June 30, and has averaged almost 21 per cent annually for the past 10 years. Eventually, this index has to come back down to earth.

### ***ISHARES S&P/TSX GLOBAL BASE METALS INDEX ETF (XBM)***

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XBM would be of interest to investors who believe that rising demand for consumer goods will drive up the price of metals such as copper, aluminum and nickel, said Steven Leong, head of the Canadian iShares product lineup at BlackRock.

There are 34 global mining stocks in the XBM portfolio, one-third of them Canadian. Another 25 per cent are U.S. companies and the rest are international. Mr. Leong said Canadian investors might have less exposure to raw materials than they imagine. “It wasn’t that long ago that energy and materials were 50 per cent of the Canadian market capitalization – today it’s 25 per cent,” he said.

XBM has already posted an 87-per-cent gain for the 12 months to June 30. But this is a sector that has seen enough adversity to have an annualized 10-year total return of just 1.8 per cent.

### ***MACKENZIE US TIPS INDEX ETF CAD-HEDGED (QTIP-NEO)***

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Michael Cooke, head of ETFs at Mackenzie Investments, likes Treasury inflation-protected securities (TIPS). Issued by the U.S. government, TIPS are designed to keep inflation from eroding your purchasing power. If inflation rises, the principal amount of your investment rises as well, and vice versa.

If the adjusted principal value of these bonds rises, so do their semi-annual interest payments. The same interest rate as before is used, but it’s applied against a bigger base. Note: Falling inflation can result in smaller interest payments.

Most bond funds have fallen a little in value so far in 2021, but QTIP has produced a total return of 6 per cent for the 12 months through June 30. Mr. Cooke acknowledges

the yield for QTIP isn't particularly attractive at 1 per cent. "But if you're looking to insulate a portfolio from the corrosive impact of inflation, this is a great way to do it."

### ***VANGUARD BALANCED ETF PORTFOLIO (VBAL)***

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Rather than trying to time portfolio changes to address inflation, Tim Huver, head of intermediary sales at Vanguard Investments Canada, suggests sticking to portfolio-building basics like diversification, low cost and a long-term perspective. As an example, he highlighted the Vanguard Balanced ETF Portfolio, which provides investors with a complete portfolio weighted 60 per cent to stocks and 40 per cent to bonds.

"We think asset allocation ETFs, VBAL as an example, are portfolios designed for all market conditions, including inflation increases," Mr. Huver said.

VBAL's 12-month gain to June 30 was 16.5 per cent, considerably less than some of the other funds listed here but still very strong in terms of a fully diversified portfolio.

<https://www.theglobeandmail.com/investing/markets/inside-the-market/article-seven-etfs-to-fight-inflations-predation-in-your-investment-portfolio/>

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