3 Ways to Profit From Rising Interest Rates

Description

In December it is widely expected that the U.S. Federal Reserve will raise interest rates for the first time since the financial crisis. If this indeed happens, it will have far-reaching consequences for stock markets all around the world.

On that note, below are three things you can do to prepare for such a scenario.

1. Buy the banks

Due to the low-rate environment, banks' margins are getting squeezed. This is because loans are far cheaper for consumers, and meanwhile deposit rates cannot go below zero. Thus an interest rate increase would be highly beneficial for financial institutions.

There are a couple of ways an investor could take advantage. One is by buying an American bank such as **Bank of America** or **Citigroup**. These stocks still trade below book value partly because investors haven't forgotten their sins during the financial crisis.

You could also buy shares of **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD). The bank actually has more branches in the United States than in Canada, and thus would benefit tremendously from an increase in rates. Yet the stock is still trading for only 13 times earnings mainly because investors are very worried about Canada's economy and the housing market. This could be a nice opportunity.

2. Buy the U.S. dollar

This is fairly straightforward. As interest rates rise in the U.S., there is more incentive to buy American bonds, which increases the demand–and value–of the greenback. Canadian investors can benefit by buying any security in American dollars.

For instance, if you are thinking of buying TD stock, you should seriously consider buying the U.S.-listed shares.

3. Sell commodities

Ever since the financial crisis, commodities have tended to move in the opposite direction of the U.S. dollar. This has been bad news for miners such as **Teck Resources Inc.** (TSX:TCK.B)(NYSE:TCK), which have seen the selling prices of their products plummet.

To be fair, an increasing greenback isn't all bad news for Teck, since the miner sells in U.S. dollars and incurs costs in other currencies. But the company's competitors have benefited in the same way, so Teck isn't really gaining an upper hand. A similar dynamic exists in the oil industry.

Rising interest rates won't help gold producers either. As rates increase, investors become less fearful of inflation, and gold loses its appeal as an investment.

So if there are any commodity producers left in your portfolio, you should probably sell them, even though they may look cheap. Better yet, if they are held in a taxable account, you can use the losses to reduce your 2015 tax bill.

CATEGORY

1. Investing

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2. NYSE:TECK (Teck Resources Limited)
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