3 Ways That Rising Rates Affect Your Portfolio

Description

On Wednesday, the U.S. Federal Reserve raised its benchmark interest rate for the first time in a decade. The so-called federal funds rate now stands at 0.50%, up from 0.25% a day earlier. The move was widely expected and signals a vote of confidence for the U.S. economy.

Of course, the Federal Reserve isn't planning to stop there. As long as the economy doesn't go through any major hiccups, interest rates should keep rising over the next couple of years.

So how does this affect your portfolio? We look at three big themes below.

1. A big plus for the banks

The low interest rate environment has not been good for banks such as **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD). The reason is quite simple: a low interest rate forces TD to charge less for loans, and deposit rates can only be lowered so much. So as rates rise, we should see American banks (or in the case of TD, banks with significant American exposure), earn higher net interest margins.

In fact, we've already seen evidence of this. Immediately after the rate hike, **Wells Fargo** raised its prime lending rate from 3.25% to 3.50%, without changing its deposit rate. Other banks have reacted in a similar way.

Here's the best part: with a bank like TD, such a tailwind may not fully be priced in. Analysts and investors are still worried about all the challenges facing the Canadian economy, so TD only trades at 13 times earnings.

2. A stronger U.S. dollar

Rising interest rates should be a positive for the U.S. dollar, which would, of course, boost any investments held in that currency. So if you're looking at a stock listed both in Canada and the United States (such as TD), you may wish to go for the American-listed shares.

3. A negative for commodities

At first glance, you would think that commodity producers such as **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) benefit from a strong greenback. After all, Teck incurs much of its costs (especially in its metallurgical coal business) in Canadian currency, while its products are priced in U.S. dollars.

But it is not that simple. Countries such as Australia are also seeing their currency depreciate against the U.S. dollar, which nullifies any advantages that Teck may have gained. And as the U.S. dollar appreciates, commodities become less affordable for countries that don’t use the greenback. The problem is especially severe for gold producers, since precious metals derive part of their value from the fear of inflation. As interest rates in the U.S. rise, those fears tend to go away.

So if you’re thinking that commodity firms such as Teck are looking cheap right now, you may want to avoid them for the time being. The pain could get a lot worse.

CATEGORY

1. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:TD (The Toronto-Dominion Bank)
2. NYSE:TECK (Teck Resources Limited)
3. TSX:TD (The Toronto-Dominion Bank)
4. TSX:TECK.B (Teck Resources Limited)

Category

1. Investing

Tags

1. Editor's Choice

Date
2025/07/20
Date Created
2015/12/18
Author
bensinclair