Where to Invest With Increasing Interest Rates

Description

South of the border, the chair of the Federal Reserve, Janet Yellen, is primed to announce a hike in interest rates in the coming weeks. Although this move may already be largely priced in to the equity markets, Canadian investors still need to stop and take a serious look at their investment holdings.

Although a small interest rate increase is by no means a disastrous event for investors, the reality is, what were otherwise fantastic returns may diminish to adequate returns. Higher interest rates translate to higher interest costs and lower net profit. Investors need to reset expectations in the years to come.

Many asset classes will decline in value if interest rates rise, so investors need to ask the question: "Where do I invest to benefit from rising interest rates?"

Obviously, long term bonds, REITs, and utility companies are not going to be anywhere the top of the list. Instead, the list will be topped by banks and insurance companies. In Canada, we have three large insurance companies that dominate the marketplace. Let's look at each insurance company.

Manulife Financial Corp. (TSX:MFC)(NYSE:MFC)

Currently, Manulife is Canada's biggest insurance company. Investors taking a new position will be offered a dividend yield of almost 3.5% and are picking up shares at a premium to tangible book value of 50% with a trailing price-to-earnings (P/E) ratio of 17 times.

Great-West Lifeco Inc. (TSX:GWO)

While the shares of Canada's second-largest insurer are much less volatile, the dividend yield is approximately 4%, and shares trade at more than double the tangible book value. Although the trailing P/E is less than 14, shares are not necessarily a fantastic deal depending on what metric is used to evaluate the security.

Sun Life Financial Inc. (TSX:SLF)(NYSE:SLF)

Shares of Sun Life offer new investors a dividend yield of just under 3.5% and trade at a premium to tangible book value in the amount of 82%. The trailing P/E ratio is currently 12.3 times.

While investors may be looking for somewhere to hide in the face of rising interest rates, the truth is that many other investors have already found their way into Canada's insurance companies and big banks. Although valuations may not seem very attractive at current levels, the importance for investors is to understand what rising rates mean for the companies they are investing in.

As insurance companies invest the premiums received (this is called the float) into short-term, very low risk investments, the increase in interest rates will greatly benefit these companies over time.

Looking at all three Canadian insurers, investors should note the volatility and dividend yield of each stock. While low payout ratios translate to more money reinvested into the company, the truth is, growth is only good if it is profitable. Sometimes boring is better!

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