Which Stocks Will Benefit From a Rising Interest Rate Environment?

Description

In an environment of rising interest rates, cyclical sectors such as energy, materials, industrials, and information technology tend to perform well. This, of course, makes sense; the reason interest rates begin to rise is because the economy is becoming stronger, and these economically sensitive sectors benefit from this.

But financials such as life insurance companies are also big, direct beneficiaries when interest rates rise.

Let's take a closer look.

Life insurance companies have assets that are primarily financial in nature and are composed primarily of bonds and stocks. Liabilities mostly consist of obligations related to the policies sold to various individuals. These companies invest their revenues and cash flows and pay their obligations with the money made from these investments.

Life insurance companies have high reinvestment risk, as they have high duration liabilities. So, when interest rates were declining, assets kept getting reinvested at lower and lower rates, which meant lower profits. Rising interest rates mean that cash flows will be invested at higher yields, and so the reinvestment risk turns positive.

In the first quarter of 2017, **Manulife Financial Corp.** (TSX:MFC)(NYSE:MFC) reported strong results with earnings per share rising 22% to $0.53, as growth in Asia and in its wealth management division were strong.

Continued strength in Asia and in wealth management, along with rising interest rates, should drive the stock's valuation higher.

According to Manulife, a 50-basis-point increase in interest rates would have a $100 million impact on net income and have a meaningful effect on its minimum continuing capital and surplus requirement ratio.

The company has raised its dividend three times in the last four years with the latest being an 11% ($0.02 per share) increase in the fourth quarter of 2016. Manulife has a healthy dividend yield of 3.28%.

Although the first quarter of 2017 was weaker than expected for **Great-West Lifeco Inc.** (TSX:GWO), the fourth quarter was strong, and management therefore increased its quarterly dividend for the first time since 2015 by 6%.

According to management, a 100-basis-point increase in interest rates would have a $145 million positive impact on net income.

Another area of strength for Great-West is its ROE, which, at 13.4%, is at the top of its peer group. Its dividend yield is currently 4.12%.

Life insurance companies are poised to continue to be winners in this environment of rising interest rates. They are already benefiting from this dynamic, but it is not too late for investors to get into these names and see their portfolios benefit as well.

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1. Dividend Stocks
2. Investing

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2. TSX:GWO (Great-West Lifeco Inc.)
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