2 Top Dividend Stocks to Bet on Higher Interest Rates

Description

Dividend investors who are looking to benefit from the rising interest rates in Canada are confused.

Banks and real estate investment trusts (REITs), which generally outperform in a rising-rate environment, are struggling. Investors are avoiding top Canadian banks on fears that the housing slowdown will spill over, hurting their loan growth and profitability.

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This is a rather complex situation for Canadian policy makers because, as the central bank started to tighten the monetary policy, the nation's overheated real estate market has begun to show signs of a steep slowdown.

Home sales in Canada's largest city, Toronto, tumbled more than 40% in July from a year ago, while prices declined 19% from their peak in April after federal and provincial governments introduced new laws to curb speculation.

The Bank of Canada hiked its benchmark interest rate in July, its first increase in seven years, bringing the rate to 0.75%. Analysts expect another hike as soon as October.

In normal circumstances, banks and REITs should benefit from rate hikes, because this move comes as the economy shows signs of strength. As businesses and consumers feel more confident, they borrow more and increase their spending.

Betting on insurance companies

If you're looking somewhere else to bet on Canadian economic strength, then I would recommend insurance companies, which seem to be the net beneficiaries in this uncertain environment for banks and REITs. Here is why.

When interest rates rise, so do the bond yields as fixed-income investors seek more returns to hedge against inflation.

Insurance companies invest a significant amount of their cash reserves in fixed-income securities, like bonds, to cover potential liabilities. Rising bond yields improve their returns, and that extra cash improves their earnings.

For dividend investors, sticking to big and quality names is probably the best strategy. For this reason, I recommend some exposure to **Sun Life Financial Inc.** (TSX:SLF)(NYSE:SLF) and **Manulife Financial Corp.** (TSX:MFC)(NYSE:MFC).

These two stocks have started to outperform the banking stocks since the Bank of Canada reversed its monetary course. Both stocks rose in the range of 4-5% during the past three months after a rather dismal performance in 2017.

There is a good reason to be bullish on these two stocks: these companies have shifted their focus to Asia to capture the the region's underserved insurance market.

And Manulife is considering spinning off its American unit, either through an initial public offering or an outright sale, according to some media reports.

Manulife's acquisition of John Hancock for $15 billion in 2004 proved to be one of the biggest drags on its profitability and share performance. If this strategic move materializes, it will unlock the true value for Manulife shares, setting the stage for upside potential.

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For income investors, investing in Canada's two top insurers also means earning nice dividend yields. Manulife offers an annual yield of 3%, while Sunlife's 3.6% is a little more attractive.

Bottom line

Investing in insurance companies is boring, and it doesn't come with massive capital gains. But if you've some extra cash, and you're looking to benefit from rising interest rates, then picking top-quality insurance stocks isn't a bad idea, especially at a time when housing-related uncertainty is clouding the outlook for banks and REITs.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:MFC (Manulife Financial Corporation)
2. TSX:MFC (Manulife Financial Corporation)
3. TSX:SLF (Sun Life Financial Inc.)

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Date
2025/08/27
Date Created
2017/08/15
Author
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