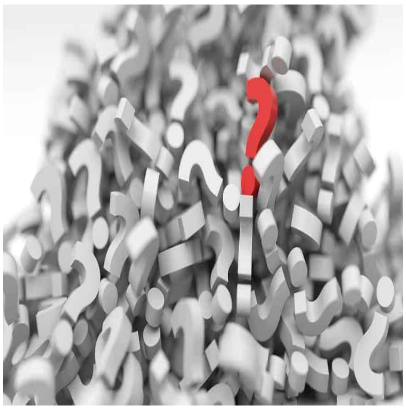

Which Stocks Should You Buy in a Rising Interest Rate Environment?

Description

On July 12, 2017, the Bank of Canada raised its overnight interest rate by 25 basis points from 0.50% to 0.75%. This was the first interest rate hike in seven years.

There is a strong possibility that there will be another rate hike before the end of the year. This indicates there is a growing confidence in the recovery of the Canadian economy.

Rising interest rates have an impact not only on bonds, but also on stocks. Some sectors are going to perform better than others following an interest rate hike.

This fact has important implications for your portfolio, since most of the returns you'll get from it comes from your sector allocation. So, if you want your portfolio to perform well during a period of rising interest rates, you may have to make some changes; that is, you should increase your exposure to some sectors and decrease your exposure to others.

We are going to look at sectors that perform well during periods of rising interest rates which you should therefore overweight.

It's time to load up on potash, mining, and gold stocks

A review of stock performances following interest rates hikes by the Bank of Canada over the past 12 years shows that materials stocks significantly outperformed all the other sectors of the Canadian market.

According to data from *Bloomberg*, the S&P/TSX materials index showed a return of 9.7% on average in the three months following a rate hike over five periods of higher interest rates, including 2010, 2007, and an extended eight-month cycle in 2005 and 2006.

The materials stocks that should perform better following an interest rate hike are those that benefit from a stronger economy, which triggers rate increases; these stocks include metal miner **Lundin Mining Corporation** (TSX:LUN) and fertilizer producer **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT).

Gold producers' stocks usually go up following an interest rate hike, which normally pushes the Canadian dollar higher. The Canadian dollar has jumped 9% since its recent low in May.

Historically, **Agnico Eagle Mines Ltd.** (TSX:AEM)(NYSE:AEM) has been among the best performers during tightening cycles.

A stronger loonie is also beneficial to retailers like **Canadian Tire Corporation Limited** (TSX:CTC.A), which imports plenty of overseas merchandise that is priced in U.S. dollars.

Banks and insurance companies will profit, too

In general, financial stocks, which include banks and insurance companies, benefit from higher interest rates.

Banks make money on their yield margin — the difference between the rate they borrow at and the rate they charge customers. When the Bank of Canada raises interest rate, banks raise their prime rates, so they make more money on lending. **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) is a strong bank that will profit from such a rise.

Insurance stocks tend to flourish as rates rise, especially life insurers' stocks, which are more sensitive to changes in interest rates than P&C insurers. In fact, the relationship between interest rates and insurance companies is linear, meaning the higher the rate, the greater the growth.

Insurers have to invest most of their money in bonds to be able to face claims anytime. A higher interest rate means they can get a higher return on their bond investments. This means a life insurer like **Sun Life Financial Inc.** (TSX:SLF)(NYSE:SLF) is going to benefit greatly from rising interest rates.

CATEGORY

1. Bank Stocks
2. Investing
3. Metals and Mining Stocks

TICKERS GLOBAL

1. NYSE:AEM (Agnico Eagle Mines Limited)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:AEM (Agnico Eagle Mines Limited)
4. TSX:CTC.A (Canadian Tire Corporation, Limited)
5. TSX:LUN (Lundin Mining Corporation)
6. TSX:SLF (Sun Life Financial Inc.)
7. TSX:TD (The Toronto-Dominion Bank)

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