



Canadian Investors: Will Rising Interest Rates Kill Your Dividend Portfolio?

Description

Investors with significant positions in Canadian dividend stocks and REITs are wondering if higher interest rates will hurt the values of their top income holdings.

Why are interest rates important?

Rising interest rates boost the return investors can get from guaranteed income investments, such as GICs. As rates on safe investments rise, investors might decide to shift funds out of equities, which carry more risk.

Higher interest rates also increase a company's cost of borrowing, and businesses that use significant debt to fuel their growth can see a drop in cash available to pay dividends when their interest payments increase.

Telecoms, REITs, and banks are popular picks among dividend investors. Let's take a look at these sectors to get a sense of how they might be impacted by rising interest rates.

Telecoms

Canadian communication companies are known for having reliable and growing dividends. These stocks also tend to offer above-average yields, so they have been a magnet for income-seeking funds.

As a result, the price-to-earnings (P/E) multiples have risen above historic norms, and that presents a risk if interest rates rise significantly, and investors shift to fixed-income alternatives.

Telecom companies also rely on debt to finance the costs of building or upgrading their wireless and wireline networks.

Stocks such as **BCE Inc.** ([TSX:BCE](#))([NYSE:BCE](#)) have already started to pull back, and while there is a risk of further downside as interest rates move higher, the market might be getting a bit ahead of itself, given the expected pace and size of the Bank of Canada's moves.

BCE now offers a yield of 4.9%.

REITs

Real estate investment trusts (REITs) are popular with income investors because they generally offer attractive yields with distributions that are often paid out monthly.

This sector is probably at the most risk of taking a big hit as interest rates rise due to the heavy reliance on debt to acquire buildings. Current loans are at very low rates, and when the time comes to renew the funding, interest rates could be significantly higher. As a result, the amount of money available to cover distributions could get reduced if revenue growth doesn't offset the higher debt costs.

REITs with lower debt ratios will be better positioned to navigate a rising rate environment.

The sell-off has already begun in many of the names, including **RioCan Real Estate Investment Trust** ([TSX:REI.UN](#)), which now provides a yield of 5.9%.

Industry-specific concerns are also at play, so investors have to separate the impact of rate fears from concerns over tenant stability, as is the case with REITs catering to the energy or retail sectors.

Banks

The Canadian banks are coming under some pressure, as investors fear rising rates might result in a housing crash. It's true that a big jump in mortgage rates could trigger a wave of defaults, and that would be negative for the banks.

However, insured mortgages represent about half of the loans for most of the banks, and the loan-to-value ratio on the uninsured part of the portfolios is low enough that house prices would have to fall significantly before the banks take a material hit.

On the other side of the equation, rising rates can increase margins on the money the banks lend and boost returns on funds they have to set aside to cover potential withdrawals.

Canadian Imperial Bank of Commerce ([TSX:CM](#))([NYSE:CM](#)) is widely viewed as the big bank with the most housing exposure, and its P/E multiple of just nine times trailing earnings shows the market's concern. The other banks are trading at 11.5-12.5 times earnings right now.

CIBC's dividend yield is 4.8%.

Should you buy, sell, or hold?

At this point, I would resist dumping your dividend stocks. If you own top-quality companies, the dividends or distributions should be safe, and any sharp pullback could present a buying opportunity.

Regarding the above sectors, the REITs probably carry the highest risk as rates rise, while the banks will likely see a net benefit. Telecom multiples could pull back if interest rates move quickly, but some of the concern might be overblown right now.

Fear can be a dividend investor's friend, and there are always opportunities out there that the market is

missing.

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2. Investing

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