Income Investors: Look for Dividend Growth as Interest Rates Rise

Description

As the Bank of Canada (BoC) begins to raise interest rates, income investors are finding it hard to find a right place to park their investments.

Investing shouldn't be that complicated, but there are some scenarios that require some serious thinking to put together a credible investment strategy by making sense of different moving pieces.

We are facing a situation when the rate-sensitive stocks — utilities, telecom and real estate investment trusts (REITs) — are under pressure as higher interest rates diminish their values when compared to the safe-haven government bonds.

The BoC raised its benchmark rate by a quarter of a percentage point last month to 0.75% for the first time in seven years as the economy shows signs of strength. The bank is expected to deliver two more hikes this year to keep inflation under control in an economy which is posting the strongest growth among the G7 economies.

If you've got bonds in your income portfolio, rising interest rates isn't good news.

Though a quarter-point increase in the BoC's benchmark rate doesn't mean that you're going to face big losses, multiple rate hikes will definitely have a drag on your fixed-income investments, as rising rates mean lower bond prices.

Canada's dividend-growth stocks

Luckily, there are still some pockets of the market that make a compelling case for income investors looking to take advantage of rising rates.

And one of them is Canadian banks. Financials should generally perform better when the bank rates increase, but they have also been weakened this year as concerns about an overheated housing market have weighed on their share prices.

Shares of **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) and **Toronto-Dominion Bank**

(TSX:TD)(NYSE:TD) have been the worst performers among the “Big Five,” falling about 9% in the past six months.

For income investors, this weakness provides a great entry point to buy one of the safest investments. The biggest selling point for Canadian banks is their growth in dividend payouts — some of the best in the world.

According to *Bloomberg’s* data, Canada’s five largest banks have averaged dividend growth of 64% since 2008 compared with 32% for the five top utilities stocks on the S&P/TSX over the same period.

Canadian banks are able to crank out more cash each quarter, helped by an oligopoly environment where the competition isn’t as stiff as you’ll find south of the border. They also work under a sound regulatory environment, where risks are well managed and the chances of 2008-type banking crisis are slim.

The recent sell-off in financials have made the banking dividend yields quite attractive. If you’ve some spare cash and are thinking to move out of bonds, Canadian banks are your best bets.

CATEGORY

1. Bank Stocks
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2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:CM (Canadian Imperial Bank of Commerce)
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Date
2025/09/13
Date Created
2017/08/23
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