What Will Rising Interest Rates Mean for the S&P/TSX Composite Index?

Description

One key question many investors have with all the talk in the media about rising interest rates in Canada and abroad is: “What does this mean for my portfolio?”

While this may seem like a simple, easy-to-answer question, the reality is the effect interest rates have on stock indices tend to be mixed, overall.

When looking at the **S&P/TSX Composite Index** (TSX:^OSPTX), the answer may be different from other indices such as the **S&P 500** or the **Russell 2000** due to the different sector mixes found in these different indices.

In Canada, the national stock market is heavily weighted toward sectors such as commodities, housing and financials (with **Royal Bank of Canada** (TSX:RY)(NYSE:RY) being the biggest of them all)**.** On balance, these sectors tend to have much higher negative correlations to rising interest rates than other sectors. In the U.S. market, however, consumer goods and technology companies comprise a higher percentage of the overall index – these industries are less prone to large movements in interest rates, often reacting slowly or not reacting at all to interest rate movements on average.

While most central banks around the world currently exist in a situation in which raising rates appears to be the only way to go – in one sense, a higher overnight lending rate is necessary for a central bank to have the ability to lower interest rates in times of crisis to prevent a depression; in another sense, rising interest rates generally follow higher inflation and therefore an improving economy – it is true that stock markets around the world have taken slight jabs every time the Federal Reserve or Bank of Canada decides to raise rates, partially due to the fact that such a move increases the cost of borrowing for investors, and thereby the cost of investing for margin accounts.

Bottom line

The S&P/TSX Composite Index is a very unique animal, as far as global indices go. Given the unique makeup of the TSX by sector weighting, as well as the country’s unique reliance on one export market for continued growth, it remains to be seen how the TSX will perform when compared to counterparts such as the S&P 500. While the so-called “Trump-rally” may officially be over, and Canada appears to be poised to outgrow the U.S. in terms of percentage growth in GDP, the attractiveness of U.S. securities to global investors continues to provide solid inflows into the S&P 500. For the time being, Canadian securities appear to be fairly valued, and decent opportunities will always exist, despite heightened valuations. The trick is to find them – good luck.

Stay Foolish, my friends.

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Date
2025/08/02
Date Created
2017/08/31
Author
chrismacdonald