Are Rising Interest Rates a Threat to Top Dividend Stocks?

Description

The Bank of Canada's (BoC) drive to hike interest rates has caused some concerns among investors looking to buy dividend stocks to improve the performance of their portfolios.

Dividend stocks generally weaken when bond yields rise. The reason is that bonds compete with dividend-paying companies for stable and regular income. As bond yields soar, investors shift assets from dividend stocks to bonds to reduce risk.

In Canada, after two interest rate increases since July, interest rate futures are signaling at least two more rate hikes in 2018.

For the first time since May 2015, the yield on the Canadian two-year government bond rose more than its U.S. counterpart, suggesting that investors are expecting the Bank of Canada will hike interest rates again.

As long as these expectations linger, investors may continue to trim their dividend holdings; in other words, they'll seek more premium when compared to safe-haven government bonds.

And this trend is already evident if you analyze the price performance of some of the best dividend stocks in Canada.

Canada's safest power and gas utilities, for example, are underperforming this year with their share prices suffering double-digit losses. **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) shares are down 12%, while the country's largest real estate investment trust (REIT) **RioCan Real Estate Investment Trust** (TSX:REI.UN) has fallen ~10%.

Should you re-adjust your portfolio?

Despite the climbing bond yields, Canadian interest rates are still near historical lows. Remember, even after 1% increase in the BoC's benchmark borrowing costs since July, all the central bank has done is remove the monetary stimulus which it provided after a sudden drop in oil prices in 2014.

Canada's 10-year government bond yield at 2.04% at the time of writing still provides dividend investors a huge margin if they have high-yielding stocks, such as Enbridge, RioCan and **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) in their portfolios. The dividend yields on these stocks range between 4% and 6%.

The other advantage of being invested in dividend stocks is that many of these companies grow their dividends regularly, providing a great hedge against rising inflation in a high-growth and rising interest rate environment.

Enbridge is targeting 10-12% annualized growth in dividends through 2024, while TransCanada has 8-10% dividend-growth target each year through 2020.

Bottom line

There is no doubt that rising interest rates aren't good news for dividend stocks in general, and it creates some nervousness in the equity market. But for the long-term, buy-and-hold investors, having some solid dividend-growth stocks is a good strategy.

These stocks beat other asset classes over the long run and generate some of the best total returns when accounting for inflation. I don't think the time is right to cut your dividend holdings and add fixed-income securities.

CATEGORY

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2. NYSE:TRP (Tc Energy)
3. TSX:ENB (Enbridge Inc.)
4. TSX:REI.UN (RioCan Real Estate Investment Trust)
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