The 3 Best Dividend Stocks to Buy When Interest Rates Rise in Canada

Description

The Bank of Canada's third interest rate hike since last summer is almost a done deal.

Economists at top Canadian banks are forecasting that the Bank of Canada governor Stephen Poloz will increase the borrowing cost by another quarter of a percentage point to 1.25% when policy makers meet on January 17. Last year, the bank hiked the policy rate twice, moving from the sidelines for the first time in seven years.

This move has implications for all of us. Canadians, who are burdened with a record level of debt, will pay more on their home lines of credit, credit card debt, and mortgages.

But there are some winners in this game, too. Banks, insurance companies, and some businesses that heavily rely on imports are going to benefit from interest rate increases if the Bank of Canada decides to act.

Here is a combo of three best dividend stocks you should consider to add to your portfolio in an environment when the economy is firing on all cylinders, and when there is no major economic threat on the horizon. These stocks suit long-term investors who want steady income during their retirement.

Sun Life Financial

Sun Life Financial Inc. (TSX:SLF)(NYSE:SLF) is a global financial services company, focusing on insurance and asset management. Sun Life stands to gain from higher interest rates, which also boost bond yields.

Insurance companies invest a significant amount of their cash reserves in fixed-income securities, like bonds, to cover potential liabilities. Rising bond yields improve their returns, and the extra cash improves their earnings.

Canadian bond yields began to surge earlier this year, with two-year rates reaching a six-year high of 1.79% after strong job-creation reports; the unemployment rate is at a 40-year low of 5.7% in December.

Sun Life Financial is a solid dividend-paying company with operations in a number of markets worldwide, including the U.S., Europe, and Asia. As of September 30, Sun Life Financial had total assets under management of $934 billion. Trading at $53.68, Sun Life Financial offers an annual dividend yield of 3.36%. The company last increased its quarterly dividend by 5% in November to $0.455 a share.

Dollarama

Dollarama Inc. (TSX:DOL), Canada's largest owner and operator of dollar stores, heavily relies on imports to buy cheaper goods from places such as China. As the interest rates rise, so does the Canadian dollar. A strong domestic currency is a great incentive for Dollarama because it cuts its costs to buy international supplies.

The company pays a meagre 0.28% dividend yield. This translates into $0.43 a share quarterly payout. But if you just focus on the company's yield, you will miss the bigger picture.

During the past five years, Dollarama produced 427% total returns, assuming you'd re-invested all your dividends back into the company. This return is massive when compared with the gains offered by some top dividend-paying stocks.

Trading at $154.74 a share, Dollarama is an expensive stock, but it has a lot positive surprises in store. Its earnings have surprised almost every year since its initial public offering (IPO) in October 2009. And those who'd bought and held at the IPO price of ~$10 have made a killing.

Toronto-Dominion Bank

Canadian banks are at the forefront to benefit from the economy, which is on a strong recovery path. They earn more when interest rate rise, as they're able to charge more on loans and mortgages.

As Canadian U.S. interest rates rise, the income from bank loans should also increase, according to Robert Sedran, an analyst at CIBC World Markets. Sedran estimates net interest income at Canada's largest banks will rise by an average of 8% in 2018, up from 6.6% growth in 2017.

My favourite pick in this category is **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) due to its well-diversified business operations and an investor-friendly dividend policy.

After a 5% increase in its payout last year, income investors in TD stock now earn $0.60 a share quarterly dividend, which translates into a 3.26% yield on yearly basis. The bank is likely to grow its dividend payout between 7% and 10% each year going forward.

The bottom line

Buying Canada's best dividend stocks that will benefit from higher interest rate is a good strategy for investors who are looking to build a stable income portfolio for their retirement.

CATEGORY

1. Bank Stocks
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1. NYSE:TD (The Toronto-Dominion Bank)
2. TSX:DOL (Dollarama Inc.)
3. TSX:SLF (Sun Life Financial Inc.)
4. TSX:TD (The Toronto-Dominion Bank)

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