What Are the Bond Markets Trying to Tell You About the Economy?

Description

Interest rates are on their way up

The yield on the U.S. 10-Year Treasury, commonly referred to as the "risk-free rate" and largely known as the universal benchmark for global interest rates, has risen 6.25% since the start of 2018, 10% since the end of November, and now sits at a nine-month high.

While 10% moves are not all that uncommon in common equity shares, for a risk free asset, the move is more than significant, and could be a sign that the era of historically low interest rates may be finally coming to an end.

Interest rates are rising in anticipation of higher inflation

The main reason interest rates have risen so much and so fast in recent weeks is that expectations are starting to form that 2018 will be a good year for the U.S. economy, and that should help pull global markets higher as well.

A good portion of this economic surge will be driven by the latest Republican tax-reform bill, which will put more money in American's pocket and create incentives for corporations to invest more for the future.

The result is what's called "demand pull inflation," where the economy experiences an excess supply of money that is being spent on goods and services, outstripping supply and pulling prices up in the process.

Inflation is good for economically sensitive stocks

An increased supply of money entering the economy is particularly good for companies that produce big-ticket items, or economically sensitive stocks.

Caterpillar Inc. (NYSE:CAT), which manufactures and sells industrial equipment, has benefited from this phenomenon, with the company's value having nearly doubled in fewer than nine months, which is particularly impressive in light of the fact that the company was already one of the world's largest.

If the forthcoming tax breaks spur Americans to go buy automobiles, Canadian auto parts manufacturer **Magna International Inc.** (TSX:MG)(NYSE:MGA) may experience similar appreciation in its shares.

Inflation is also good for commodity producers

Increased expectations for inflation has historically also provided a boost to commodity producers like **Teck Resources Ltd.** (TSX:TECK.B)(NYSE:TECK), which happens to be one of the world's largest producers of metallurgical coal used to make steel as well as copper and zinc.

Teck's shares are up 91% since May, including a strong showing last week, gaining more than 12%.

But higher rates are bad for utilities and REITS

However, not every sector stands to benefit from higher interest rates.

REITS like **Dream Office Real Estate Investment Trst** (TSX:D.UN) should expect to see an increase in the cost of the debt they issue that helps them to add properties to their investment portfolio.

Utility-like companies could see some adverse effects as well. **Enbridge Inc.** (TSX:ENB)(NYSE:ENB), which is a company largely driven by its dividend, may see investors move out of the stock as they search for safer, but similar yields from fixed-income instruments like corporate bonds and preferred shares.

Don't forget about e-commerce, one of the fastest-growing sectors

While higher interest rates may sound scary on the surface, don't forget that they're actually indicative of expectations for a stronger economy that's largely driven by increased consumer spending.

With consumers increasingly making their purchases via e-commerce channels, digital retailers like **Amazon.com, Inc.** (NASDAQ:AMZN) should be getting a push too in 2018.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NASDAQ:AMZN (Amazon.com Inc.)
2. NYSE:CAT (Caterpillar)
3. NYSE:ENB (Enbridge Inc.)
4. NYSE:MGA (Magna International Inc.)
5. NYSE:TECK (Teck Resources Limited)
6. TSX:D.UN (Dream Office Real Estate Investment Trust)
7. TSX:ENB (Enbridge Inc.)
8. TSX:MG (Magna International Inc.)
9. TSX:TECK.B (Teck Resources Limited)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Dividend Stocks
2. Investing

Date
2025/08/15
Date Created
2018/01/17
Author
jphillips