Which Stocks Will Be the Hardest Hit as Bond Yields Rise?

Description

Rising interest rates affect the stock market in many ways.

First, it becomes more expensive for companies and consumers to borrow, thus bringing down growth numbers.

Second, rising interest rates make bonds more attractive again for investors, thus reducing demand for stocks.

And third, rising interest rates increase the denominator in the present value calculation, so when we discount future cash flows of companies, the present value result is lower, thus driving down valuations.

It follows that those stocks that are the most overvalued will be the hardest hit. Stocks of companies in the cannabis industry are the most at risk at this time due to their sky-high valuations and the fact that a lot of the expectations that are built in to the stocks are based on numbers many years out.

Canopy Growth Corp. (TSX:WEED) trades at an absurdly high valuation of 101 times sales. The stock has a six-month return of 252%, but it has come down 24% since highs hit earlier this year.

And **Aurora Cannabis Inc.** (TSX:ACB) trades at a price-to-sales multiple of more than 200 times. The company has shown that it will really pay up to grow its business.

Aurora effectively increased its offer price for **Cannimed Therapeutics Inc.** (TSX:CMED) from the initial $24 per share back in November to $44 per share recently. That's almost double the initial offer and shows little discipline or patience, in my view. The company is issuing shares to fund this purchase, thereby diluting shareholders.

These types of stocks will be hit the hardest.

So, where should investors turn once they have exited these high-risk stocks?

Insurance companies, like **Manulife Financial Corporation** (TSX:MFC)(NYSE:MFC) and other financials, stand to benefit from rising rates.

Although the stock has performed well this year, Manulife currently still trades at attractive multiples given the improved environment expected in 2018 and its growth profile.

The company is currently seeing strong growth in Asia, where earnings increased 16% on a constant-currency basis in the third quarter, and solid performance in its wealth management segment, where the Standard Life and the New York retirement plan acquisitions will help to boost its position and growth going forward.

With a primary focus on the Canadian market, **Industrial Alliance Insur. & Fin. Ser.** (TSX:IAG) stands to gain the most of its peer group from rising interest rates.

The company has disclosed that a 10-basis-point increase in interest rates will impact net income by $15 million.

In summary, historically, rising bond yields foreshadow a fall in the stock market, so investors should begin to position themselves for it. That means staying away from high-flying stocks that trade at sky-high valuations and favouring those companies that are more attractively valued and/or that will be beneficiaries of rising rates.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:MFC (Manulife Financial Corporation)
2. TSX:ACB (Aurora Cannabis)
3. TSX:IAG (iA Financial Corporation Inc.)
4. TSX:MFC (Manulife Financial Corporation)
5. TSX:WEED (Canopy Growth)

PARTNER-FEEDS

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

Category

1. Bank Stocks
2. Dividend Stocks
3. Investing

Date
2025/07/05
Date Created

2018/02/03
Author
karenjennifer