Income Investors: Here’s an Investment Strategy to Help You Thrive in a Rising Interest Rate Environment

Description

As an income investor, a rising interest rate environment is typically bad news. Both the Fed and the Bank of Canada have been pulling the trigger on rate hikes of late, and as the years pass, investors should brace themselves for rate hikes coming at a fast and furious rate.

Ready or not, higher interest rates are coming. It’s a tough pill to swallow for those who have gotten used to dividend hikes and capital gains from their REITs, utilities, and telecoms, all of which are poised to deliver modest total returns in the era of rising rates.

How should income investors adapt as rates continue to rise?

Unfortunately, there’s no simple solution for conservative income investors like retirees, who can’t afford to take on additional risks to achieve a better total return as rates continue on their upward trajectory. We’ve been enjoying rock-bottom interest rate for quite some time, but just because the good times are over doesn’t mean you should make major changes to your portfolio if it’s still in line with your long-term goals.

For now, let’s say your primary goal is receiving monthly income from your defensive positions. You’ll still get the steady stream of income in a rising-rate environment. Nothing will change about that, so put your dividend/distribution cut fears to rest.

The major problem lies in the fact that capex-intensive, high-payout sectors like real estate, telecom, and utilities will grow at a more modest rate than in the past, since borrowing will gradually become more expensive. That means, on average, a potentially rockier stock chart of low-beta securities (like REITs, telecoms, or utilities) to go with a lesser magnitude of dividend/distribution increases.

For income investors who aren’t dependent on income payouts, but who also care about their total returns over the medium to long term, a rising-rate environment could be enough of a reason to move capital out of the REIT, utility, or telecom sectors and into the more attractive financial sector, where higher rates serve as a tailwind rather than a headwind. That’s fine; however, such a move probably isn't the best move for a retiree who values extremely low volatility almost as much as the magnitude of the dividend yield.

A strategy to ride out volatility as a retiree without taking on additional risk

Such retirees should stick with REITs, utilities, or telecom sectors, despite the headwind of rising rates, but keep a little bit of cash on hand to buy your favourite income stocks on any meaningful dips, which may be induced by faster-than-expected rate hike fears.

Consider the sharp February dip, which saw the average REIT surrender ~5% in just a few weeks. These interest rate fears are going to cause a rocky road, so if you've got the capacity to buy on such dips, you'll be able to ride out the rough terrain without worrying too much about volatility surges. This is an intriguing strategy for a retiree who cares about income, but who also care about achieving a higher total return over the years as interest rates continue to move up.

Consider **Killam Apartment REIT** (TSX:KMP.UN), a 4.53% yielder that's plunged over 13% in under two months thanks in part to interest rate fears. That's a larger-than-average movement, which may have spooked investors, but those who'd bought on the dip locked in a higher yield that didn't last very long, as shares rebounded ~7.5% in a few weeks.

As a retiree, you probably just want to set it and forget it. That's understandable, but just keep in mind that rate-induced dip could make way for opportunities for you to get a leg up on your favourite income payers. If you've got a cash hoard, then you're well equipped to ride out a rising-rate environment without taking on more risk by moving capital to more volatile sectors.

Stay hungry. Stay Foolish.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:KMP.UN (Killam Apartment REIT)

PARTNER-FEEDS

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

Category

1. Dividend Stocks
2. Investing

Date
2025/08/26
Date Created

2018/02/27
Author
joefrenette