As the Bank of Canada Increases Rates, Investors Can Still Bet the Farm and Win Big!

Description

Earlier today, the Bank of Canada announced an interest rate hike of 25 basis points (also expressed as 0.25%), which will make it costlier for consumers and businesses to borrow money. The impact this will have on the economy is not a positive one. As a reminder, higher costs of borrowing are typically found in very strong economies (in an effort to slow them down), while lower interest rates will serve to increase new borrowing and hopefully encourage new capital projects (and increase hiring).

For investors in a number of sectors, higher interest rates will be detrimental, as consumers will have fewer dollars (also known as disposable income) to spend on purchases. Shares of restaurant companies such as **Boston Pizza Royalties Income Fund** (TSX:BPF.UN) may suffer greatly as consumers (mostly middle-class income earners) will have yet another expense to juggle before going for an evening out. To make things more interesting for investors, a higher risk-free rate of return will make any dividend yield seem less attractive on a comparison basis. Although this name offers a very generous 7%, many names that pay between 3% and 4% may no longer offer an edge to investors.

On the flip side, those who invest in deposit-taking institutions such as banks and finance companies may just be in the best position of all. As rates increase, so too will revenues of institutions that loan money on a variable basis. As many of our big banks are well covered and well diversified, investors may want to take a good look at names such **Home Capital Group Inc.** (TSX:HCG), as the lender's fortunes are closely tied to the level of interest rates.

At a current price near $15 per share, the lender continues to trade at a substantial discount to tangible book value and will have a lot of cash available to undertake a share buyback. As existing mortgages run off and fewer new mortgage originations are undertaken, the capital will eventually have to deployed somewhere — hopefully, in the hands of investors.

Where interest rates won't matter

The oil industry is experiencing a massive explosion in demand, as very low oil prices have hindered any new production. As the glut in supply has finally been used up, investors have seen the price of oil return to a healthy US$73 per barrel, which will see an uptick in almost all areas of the oil industry.

The best bet for investors may come from shares of **Pembina Pipeline Corp.** (TSX:PPL)(NYSE:PBA), which will have the opportunity to capitalize on the increase of oil production from any producer. As the demand in oil continues to increase each year (no matter the interest rate), the question that investors need to consider for this industry (and all others) remains the same: How will higher interest rates impact the competitive landscape?

In the oil industry (as with many others), the higher cost of undertaking new projects will make it costlier to enter the market. In the restaurant industry, the greater impact will instead be felt by the consumers, as they will spend less money eating out.

As is the point in raising rates, the Bank of Canada wants to impact the behaviour of consumers. Companies and investors alike should not be surprised, as the Bank of Canada has proven to be successful many times in the past.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:PBA (Pembina Pipeline Corporation)
2. TSX:BPF.UN (Boston Pizza Royalties Income Fund)
3. TSX:HCG (Home Capital Group)
4. TSX:PPL (Pembina Pipeline Corporation)

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