2 Stocks to Own in a Rising Interest Rate Environment

Description

The Bank of Canada raised interest rates four times in the past year, and additional increases are likely on the way.

Why?

Canadian inflation is at its highest level since 2012, according to the latest Statistics Canada report, providing support for the Bank of Canada's most recent decision to raise interest rates amid the ongoing trade uncertainties.

The June Consumer Price Index (CPI) rose 2.5% on a year-over-year basis, above the Bank of Canada's long-term target inflation rate of 2%. A solid retail sales report also came out, suggesting the economy remains strong, despite all the noise about consumer debt levels and threats of a recession triggered by a potential trade war with the United States.

The U.S. Federal Reserve has tightened even more in the past two years, and that trend is set to continue amid record-low unemployment and the potential for an overheated economy triggered by tax cuts.

Investors have to keep the rate outlook in mind when making new buy decisions for their portfolios. Some sectors tend to react negatively when interest rates rise, while others can benefit.

Let's take a look at **Sun Life Financial Inc.** (TSX:SLF)(NYSE:SLF) and **Bank of Montreal** (TSX:BMO)(NYSE:BMO) to see why they might be interesting picks.

Sun Life

Sun Life owns insurance, wealth management, and asset management businesses in Canada and the United States. It also has a growing international presence, with a strong focus on Asia.

Insurance companies are required to set aside a large chunk of cash to cover potential claims. A significant part of this money is placed in fixed-income investments, so rising interest rates tend to bode well for the return the funds can generate. When you are looking at billions of dollars, a 1% increase goes a long way.

On the wealth management side, rising rates normally occur in times of strong economic conditions, as we see today, and that goes hand in hand with rising stock markets and wealth expansion as business owners and investors see their net worth rise. The flurry of wealth management deals by the big banks this year is an indication of the value of these businesses right now.

Sun Life has recovered from the hit it took during the Great Recession and made moves in recent years to insulate the company from a recurrence, including the sale of the U.S. annuities business and acquisitions in the asset management space.

Bank of Montreal (TSX:BMO)(NYSE:BMO)

Bank of Montreal could prove to be a top pick among the big banks as rates continue to rise, pushing up net interest margins.

The company has a smaller Canadian residential housing exposure on a relative basis than its peers, so a drop in house prices poses less risk. At the same time, the large U.S. division gives the company an opportunity to benefit from rising net interest margins in both Canada and the United States.

This might be why Bank of Montreal is trading at a such a strong price-to-earnings multiple today.

Is one more attractive?

At this point, I would probably make Sun Life the first choice for a buy-and-hold portfolio. The insurance and wealth management divisions should do well as rates rise and the Asian operations provide good exposure to long-term middle-class expansion in countries such as India, China, and Indonesia.

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Author
aswalker