

Dividend Investors: Should You Buy BCE Inc. (TSX:BCE) or Royal Bank of Canada (TSX:RY) Stock As Interest Rates Increase?

Description

The tide has turned at both the Bank of Canada and the U.S. Federal Reserve, which has implications for investors who are searching for [top stocks](#) to add to their income portfolios.

Let's take a look at **BCE Inc.** ([TSX:BCE](#))([NYSE:BCE](#)) and **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)) to see if one is a better choice in this environment.

BCE

Rising interest rates are perceived as being a headwind for traditional go-to dividend stocks in the telecom and utility sectors.

Why?

As rates fell during the Great Recession, risk-averse income investors who needed to get better returns on their savings shifted funds out of GICs and into dividend stocks that offered reliable payouts with attractive yield. BCE is one of those names, and the stock likely received some added momentum as a result of the strong demand.

Now that interest rates are beginning to move in the other direction, there is a risk that money will exit the dividend stocks that benefitted in recent years and move back into GICs. That process might have already begun, or at least, investors are expecting it to happen, as BCE's share price has dropped from close to \$63 per share last fall to the current price of about \$55.

Higher rates also make debt more expensive, and the telecoms and utilities tend to use debt to help fund acquisitions or major network and infrastructure upgrades. As borrowing costs rise, there could be less cash available to pay dividends.

Five-year CDIC-insured GIC rates above 3% are currently available from several Canadian financial institutions, so dividend stocks certainly have more competition.

BCE raised its dividend by 5% earlier this year, and the current payout provides a [yield](#) of 5.5%. That's still a nice premium over a fixed-income alternative, but investors have to be mindful of the fact that BCE will continue to grow and increase the payout at an attractive rate in the coming years.

Earnings were flat on a per-per share basis in Q1 2018 compared to the same period last year. The company is targeting EPS growth of 1-3% for 2018.

Royal Bank

Higher interest rates are a two-sided coin for the banks.

A sharp increase in rates over a short period could force some Canadian homeowners to sell their houses when they have to renew their mortgages. If the situation gets out of hand, house prices could fall dramatically, which would be negative for the banks.

However, higher interest rates also tend to increase net interest margins (NIM) at the banks, which is good for the bottom line. For example, Royal Bank's fiscal Q2 NIM was 2.74%, compared to 2.62% in the same period last year. In addition, wealth management and insurance operations can also benefit from higher interest rates.

Royal Bank's stock is down from a high of \$108 in January to the current price of about \$101. The company raised the dividend twice last year for a total increase of nearly 10%. Investors already received a 3% increase this year, and another hike should be on the way. The dividend provides a yield of 3.7%.

Earnings per share increased 11% in fiscal Q2 compared to the same period last year. Management is targeting annual EPS growth of at least 7% over the medium term.

Is one more attractive?

While BCE arguably looks a bit oversold today, there is a risk the stock could continue to give back some ground on concerns over long-term growth opportunities. Royal Bank's EPS growth outlook is likely better over the medium term.

If you think interest rates are headed higher for the next few years, I would make Royal Bank the first pick today.

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