Up More Than 3%, Why Yesterday Was Manulife (TSX:MFC) Stock's Best Day in More Than a Year

Description

The financial sector rallied in Wednesday's trading after the yield on 10-year U.S. Government Treasuries rose to its highest level in four months.

Some of the world's largest banks showed strong gains, including the likes of **JPMorgan Chase** and **Citigroup**, up by 1.81% and 1.65%, respectively, while U.S.-based insurance companies also performed well, with **Prudential Financial** up 2.83% and **Principal Financial Group** gaining 2.37%.

However, leading the pack was none other than Canada's insurance sector.

Shares in **Sun Life Financial** gained 2.3% on Wednesday, while competitor **Great-West Lifeco** was also up 2.3% and has continued to gain in Thursday's session, now up 3.6% over the past two days.

However, outperforming them all was **Manulife Financial** (TSX:MFC)(NYSE:MFC), which saw its shares spike, closing 3.2% higher for the day, and making it MFC stock's best day in more than a year.

Manulife stock has lagged its smaller rival Sun Life over the past five years, but there's a good chance that yesterday's outperformance could act as something of a catalyst and an indication that MFC stock is about to start making up some of the lost ground on its closest peer.

Like banks that benefit from charging higher interest rates on their loans, insurance companies too benefit from a rising interest rate environment just by the very nature of how the insurance business works.

How the insurance business works

When a Manulife client pays their premium to the company, it then takes those funds and reinvests them in a diversified portfolio that it expects to earn a positive return on.

That portfolio can include an allocation towards the stocks of publicly traded companies and sometimes even alternative assets, like real estate and hedge funds, but more often than not, the majority of an insurance company's investment portfolio is held in fixed-income securities, such as corporate bonds or the debt of domestic and foreign governments.

The job of the portfolio managers at those insurance companies is to take the received premiums, invest them, and earn a positive return that can then be returned to its clients to reimburse them for their filed claims.

The difference between the returns earned on its investment portfolio and the money that is paid out to clients on their claims is the "spread," or the money that the insurance company nets as a profit to keep and, if it chooses to, return to shareholders in the form of either dividends or share buybacks.

Are insurance companies about to take off?

Part of the job of a successful insurance company is to underwrite its policies profitability, which is a different story altogether.

But as they say, "a rising tide lifts all boats," and while underwriting profitability among firms tends to ebb and flow in a cycle of its own, a rising interest rate environment can be good for all parties involved.

Higher interest rates earned on Manulife's fixed-income portfolio should help to boost the insurer's profits and, in doing so, could pave the way for more aggressive increases to MFC stock's current 3.64% dividend yield.

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