The Rising Interest Rate Trade Has Just Begun: Ignore It at Your Own Peril

Description

In the span of only one-and-a-half years, Bank of Canada has increased its benchmark interest rate by a full percentage point to the current 1.5%.

Although this is still low, it is a meaningful change, and rates will be increased even further. The big beneficiaries of this rising interest rate environment are life insurance companies such as **Manulife Financial Corp.** (TSX:MFC)(NYSE:MFC).

Life insurance companies have assets that are primarily financial in nature and are composed primarily of long-term bonds. Liabilities mostly consist of obligations related to the policies sold to various individuals. Life insurance companies have high reinvestment risk, as they have high duration (long-term) liabilities.

So with declining interest rates, assets kept getting reinvested at lower and lower rates, which meant lower and lower profits. But today we're seeing rising interest rates, which means that cash flows will be invested at higher yields, and so the reinvestment risk turns positive.

According to Manulife, a 50 basis point increase in interest rates would have a $100 million impact on net income and have a meaningful effect on its MCCSR ratio or its Minimum Continuing Capital and Surplus Requirement Ratio. But this takes time to show up in the results, as reinvestment happens little by little over time.

With a market capitalization in excess of $50 billion, Manulife is a force to be reckoned with, with a strong past and a very promising future.

In the past five years, the company has seen a 15% compound annual growth rate (CAGR) in core EPS, a 28% CAGR in the business value in Asia, and strong growth in its global wealth and asset management business, with a 20% CAGR in assets under management.

Canadian bank stocks also benefit from rising interest rates as their net interest margins will rise in this environment.

Royal Bank of Canada (TSX:RY)(NYSE:RY) is Canada's largest bank by a small margin that has shrunk over the last few years, with assets of more than $1.3 trillion, market capitalization of approximately $150 billion, and the number one market share in many of its business lines such as personal loans and mutual funds.

Royal Bank stock has a dividend yield of 3.93% and its dividends have grown at a compound annual growth rate of 6.52% in the last 10 years.

With total assets of $1.3 trillion, up from $563 billion in 2008, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) is fast approaching Royal Bank to become Canada's largest bank by assets. TD's strategy has been to focus on the lower risk retail side of the business and continue to expand in the U.S.

The success of this strategy is evidenced by the fact that TD Bank is now the sixth largest North American Bank by total assets and by market capitalization. TD bank stock currently pays a dividend yield of 3.58%, and the dividend has grown at a compound annual growth rate of 9.14% in the last 10 years.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:MFC (Manulife Financial Corporation)
2. NYSE:RY (Royal Bank of Canada)
3. NYSE:TD (The Toronto-Dominion Bank)
4. TSX:MFC (Manulife Financial Corporation)
5. TSX:RY (Royal Bank of Canada)
6. TSX:TD (The Toronto-Dominion Bank)

PARTNER-FEEDS

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

Category

1. Bank Stocks
2. Dividend Stocks
3. Investing

Date
2025/09/11
Date Created
2018/10/19
Author
karenjennifer