What Does an Impending Rate Cut Mean for Your Portfolio?

Description

On Wednesday, the Bank of Canada held interest rates steady amidst an uncertain economic backdrop. Trade wars, the U.S. and China conflict in particular, is beginning to have a significant impact on the global growth. According to the bank, “As the U.S.-China conflict has escalated, world trade has contracted and business investment has weakened.”

Holding rates steady was largely expected; however, economists have now turned increasingly bearish. The bank stated that “escalating trade conflicts and related uncertainty are taking a toll on the global and Canadian economies.” The bearish tone has economists speculating that an interest rate cut is looming, perhaps as soon as this fall.

With this in mind, how should investors structure their portfolios? The financial industry has been operating in a low interest rate environment for some time. An interest rate cut is both a positive and a negative for Canada’s banks.

It is no secret that Canadians have a high level of debt. Several reports over the past few years have raised concerns that a rise in interest rates would lead to a significant uptick in loan defaults. This would lead to greater impairment charges and reduced profit for Canada’s banks. As such, a steady or declining interest rate would help stem the tsunami of potential defaults.

However, margins would be negatively impacted. In a declining interest rate environment, banks earn less of a spread between what they pay savers and what they can earn from debt. If the feds decide to cut rates by 25 basis points this fall, it should not impact financials to any significant degree.

Where to park your money

If not financials, then what companies are best positioned to benefit? The best stocks to own are those that have significant capital expenditures and that pay a dividend. As such, the utility, telecom, and midstream industries would be expected to outperform.

The upwards trend has already begun. Over the past three months, the TSX has been highly volatile and has eked out a 1.27% return. Utilities have outperformed, and in some cases have returned double digits. Case in point, **Emera** is up 11% over the past three months ad 41.03% over the past year. It has been the best performing company in the industry.

Emera yields a juicy 4.04% and has a 12-year dividend-growth streak. The company is expected to raise dividends by mid-single digits over the next few years. As one of the smaller industry players, it is well positioned to outperform.

Pipelines are also starting to outperform. **TC Energy** is up 16% over the past six months and 25% in the past year. TC Energy is one of the top dividend-growth stocks in the country. It is a Canadian Dividend Aristocrat that has raised dividends for 18 consecutive years, and at 4.33%, its current yield is an attractive alternative to fixed-income investments. Over the past 10 years, it has averaged double-digit dividend growth, which is the top growth rate in the industry.

Finally, the telecom industry is also seeing a resurgence. The largest player in the country, **BCE** is now trading at all-time highs. The company's stock price is up 18.45% over the past year, as it finally broke through resistance after four years of bumping up against the $63 mark before retreating. With momentum on its side and a rate cut on the horizon, BCE is now in blue-sky territory.

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