2 Top ETFs to Buy Before Interest Rates Rise

Description

The Bank of Canada (BoC) held the benchmark interest rate at 0.25% during its meeting on December 8. Inflation in Canada has shot up to an 18-year high in late 2021. The pressure is on central banks to beat back this trend that is putting the squeeze on consumers. Oddsmakers are projecting that the BoC will pursue several rate hikes in 2022. Today, I want to look at two exchange-traded funds (ETF) that will be well positioned in a rate-tightening environment. Moreover, I want to look at an ETF that is also worth avoiding in this climate. Let's jump in.

Here's why banks are a perfect target when interest rates rise

In November, I'd suggested that investors should target financial-focused ETFs, as we prepare for rate tightening. Investors may want to consider **BMO Equal Weights Banks ETF** (TSX:ZEB) ahead of the New Year. This ETF offers exposure to the top Canadian banks. Its shares have climbed 31% in 2021 as of early afternoon trading on December 8. It is equal weighted to mitigate risk.

Canadian banks have expanded their loan portfolios in a friendly credit environment. Higher rates will put pressure on credit growth, but it will also lead to improved profit margins for Canada's top financial institutions. This ETF possesses a solid MER of 0.28%. Investors will be well acquainted with the top holdings in the account, which include **TD Bank**, **Scotiabank**, and **Bank of Montreal** in the top three biggest weightings. Its shares have dipped 1.2% in the month-over-month period.

Commodity-focused ETFs may be dangerous as rates increase

Commodities have thrived in 2021 as an improved global economy has led to surging demand. The oil and gas sector have performed particularly well over the past year. Higher interest rates have historically put pressure on commodity prices. Investors may want to avoid ETFs like **iShares S&P/TSX Capped Energy ETF** (TSX:XEG) as we look ahead to the New Year.

Shares of this ETF have shot up 80% in 2021 on the back of the energy resurgence. Rate tightening could torpedo the momentum that has been built in this space. Investors may want to consider taking profits in oil and gas assets as we prepare for rate hikes.

Why I'm considering this ETF in the event of rate hikes in 2022

Bond funds are another interesting target as we look ahead to a potential rate-tightening cycle. These ETFs can also provide a hedge against a volatile equities market that could emerge as interest rates rise. **BMO Ultra Short-Term Bond ETF** (TSX:ZST) is designed to provide exposure to a diversified mix of short-term fixed-income asset classes. It also boasts a low MER of 0.15%.

This ETF has dropped 1.9% in 2021 at the time of this writing. Investors should consider targeting this ETF ahead of the New Year. It can provide stability and some steady gains, as central banks look to combat inflation.

CATEGORY

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Date
2025/08/19
Date Created
2021/12/08
Author
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