2 TSX Financial and Bank ETFs That Could Benefit From Interest Rate Hikes

Description

The Bank of Canada (BoC) is poised to implement its largest interest rate hike since 1994. Economists are currently predicting a 75-basis-point (0.75%) increase on Wednesday July 13.

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Earlier on June 1, the BoC raised rates by 50 basis points, but this had no effect on inflation, which hit a new year-over-year high of 7.7% in May. The upcoming rate hike is likely to have a negative effect on long bonds and growth stocks, with both suffering heavily year to date.

However, not all market sectors are affected badly by rising interest rates. Certain ones, like the financial sector, have historically shown improved profitability in a rising interest rate environment. In this situation, they can charge higher interest rates on loans, which increases their revenue and profitability.

For this reason, the stocks of banks, asset managers, lenders, and insurance companies could be good buys right now, especially given their historically strong dividend payouts and good balance sheets. A great way to buy a portfolio of these stocks is via an exchange-traded fund (ETF).

Canadian bank stocks

Canada's so-called Big Six bank oligopoly includes **Royal Bank of Canada**, **Toronto-Dominion Bank**, **Canadian Imperial Bank of Commerce**, **Bank of Nova Scotia**, **Bank of Montreal**, and **National Bank**. Investors keen on owning all six banks can buy **BMO S&P/TSX Equal Weight Bank Index ETF** (TSX:ZEB).

ZEB holds shares of all six banks in equal weights, thus saving investors the time and cost of manually purchasing and re-balancing a portfolio. The fund manager charges a management expense ratio of 0.28%, which works out to around $28 annually on a $10,000 portfolio.

Because the underlying bank stocks in ZEB often pay strong dividends, the fund itself pays a decent distribution yield of 4.20%. What's cool is that ZEB pays out distributions monthly versus the quarterly dividends individual bank stocks pay. This makes ZEB great for income investors.

Canadian financial sector stocks

The TSX financial sector contains a slew of high-quality companies outside of the Big Six bank stocks, such as asset managers and insurance companies. Examples include **Brookfield Asset Management**, **Power Corporation**, **Manulife Financial**, and **Sun Life Financial**.

A great way to buy these stocks and the previously mentioned Big Six bank stocks is via **iShares S&P/TSX Capped Financials Index ETF** (TSX:XFN). Compared to ZEB, XFN holds 28 stocks and is much more diversified given that it's not concentrated in the banking sector.

The downside of XFN is its much higher management expense ratio. Currently, this sits at 0.61%, or $61 for a $10,000 investment. The distribution yield is also lower at 3.51%, which may not be as desirable for income investors. Still, for broad diversification, XFN is a better bet.

The Foolish takeaway

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Tilting your portfolio toward the financials sector using ETFs could be a good defensive play in a rising rate environment and a cost-effective, accessible alternative to stock picking.

If managing a portfolio of stocks and keeping up with research seems tedious and time consuming to you, an ETF might be the way to go. It requires less capital and saves you the need to manually re-balance holdings. You're also less tempted to tinker, which saves on fees and helps you avoid rash, emotional trading decisions.

That being said, investors looking to tilt their portfolios to financial or banking stocks via ZFN or ZEB should consider keeping the overall allocation small. Over the long run, broad diversification via index funds is still best.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. TSX:XFN (iShares S&P/TSX Capped Financials Index ETF)
2. TSX:ZEB (BMO Equal Weight Banks Index ETF)

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