2 Stocks That Actually Benefit From Rising Interest Rates

Description

Soaring interest rates are causing grief for businesses that have large levels of variable-rate debt. However, rising rates also drive up the return companies can get on cash they need to set aside to meet customer or employee obligations. Higher rates can also boost net interest margin for business that lend to commercial and retail clients. Insurance stocks and bank stocks, for example, can benefit from rising interest rates.

Manulife

Manulife (TSX:MFC) operates insurance, wealth management, and asset management businesses located primarily in Canada, the United States, and Asia.

Insurance companies are required to keep significant amounts of money available to cover potential claims. When interest rates are very low, it is difficult for Manulife to generate income on these pools of money. The sharp surge in interest rates in Canada and the United States in recent months should have a positive impact on fourth-quarter 2022 and 2023 results.

This can help offset some of the negative effects of the decline in equity markets this year and the hit from COVID-19. Reduced equity values can lead to lower wealth management fees. The Omicron surge in the early part of 2022 pushed up morbidity and mortality claims in Canada and the United States. Lockdowns in Asia this year have hindered product sales.

The markets might be in for a volatile ride in the first half of 2023, but the second part of next year could see a solid rebound. COVID-19 effects should fade in 2023. At the same time, interest rates could continue to climb higher, so the returns on cash holdings should increase.

Manulife trades near $24 per share at the time of writing compared to a 2022 high of about $28. Investors who buy at the current level can get a 5.5% dividend yield.

TD Bank

TD (TSX:TD) has large retail banking operations in Canada and the United States. The company built a war chest of excess cash during the pandemic and is using a good chunk of the funds to make two strategic acquisitions south of the border. The purchase of **First Horizon** will expand TD's American business by more than 400 branches, which are largely located in the southeastern part of the country. This is a good fit with the current network of branches that extends from Maine to Florida.

Once the First Horizon deal closes, TD will become a top-six bank in the U.S. market. TD is also buying **Cowen**, an investment bank, to boost its capital markets capabilities.

Banks make money by lending cash at higher rates of interest than what they pay to depositors who keep their funds at the bank. As interest rates rise, banks tend to see an expansion of their net interest margins.

Like the insurers, banks also have to maintain certain capital reserves. This is to cover potential withdrawals and to ride out challenging economic conditions. As rates rise, TD and its peers can earn higher returns on this pile of cash.

TD generated solid fiscal 2022 results with adjusted net income coming in at $15.43 billion for the year compared to $14.65 billion in fiscal 2021. Management expects adjusted earnings per share to expand by 7-10% in 2023. This is encouraging considering the economic headwinds.

TD trades near $90 per share at the time of writing compared to $109 at the 2022 peak. Investors who buy the stock at the current price can get a 4.25% dividend yield.

The bottom line on stocks that benefit from higher interest rates

Manulife and TD should benefit from higher interest rates as returns on cash positions rise and net interest margins expand. This can help offset some of the negative effects. The market might not fully appreciate the positive side of rate hikes, and these stocks are likely undervalued today.

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2. Investing

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