Stubborn Interest Rates: 2 TSX Stocks That Can Play Along (and Even Win)

Description

The Bank of Canada (BoC) raised the target for the overnight interest rate *again* last month — this time by 0.25%. This raise came after a total increase of 4.0% in 2022. Thankfully, the BoC indicated that it won't be raising rates for the next while. However, that doesn't mean interest rates are coming down either. Instead, the target rate is likely to maintain at 4.50% over the near term, as the BoC observes how the higher rates traverse across the economy and curb inflation.

The interest rate hikes appear to be taking some effect. Inflation fell from the 8.1% peak in June 2022 to 6.3% in December 2022. The BoC further projected that the inflation will "fall to around 3% in the middle of 2023 and reach the 2% target in 2024."

Interest rates are going to stubbornly stay at current levels over the next six months or so. Higher interest rates generally mean higher borrowing costs for businesses and consumers alike. This seems like bad news for the economy. However, some businesses are set to benefit.

How interest rates benefit TD Bank stock

Toronto-Dominion Bank (TSX:TD) stock is a core dividend holding in diversified investment portfolios. It is a top bank in North America — the fifth largest by total assets and market cap. The bank primarily provides retail banking services in Canada and the United States. It also has operations in wealth management and insurance. Altogether, it has about 2,220 retail locations in North America.

At the end of fiscal 2022, it took the first place in total assets ($1.9 trillion) and total deposits ($1.2 trillion) in Canada. When interest rates rise, banks are generally able to lend money at a higher rate versus the interest paid out on deposits. This is the case for TD Bank. In fiscal 2022, the top Canadian bank earned 13% higher in net interest income year over year. This helped drive revenue growth of 15%. Ultimately, adjusted earnings per share rose 5.7% to $8.36 in fiscal 2022.

TD stock is awarded an S&P credit rating of AA-. Investors can buy and hold the shares for the long haul and expect below market risk and above-average market returns. Just ensure you target good valuations for your purchases.

At $92.22 per share at writing, the bank stock trades at a reasonable valuation at roughly 10.8 times earnings. At this quotation, it offers a decent dividend yield of 4.2%. Its payout ratio is sustainable at about 43%.

Sun Life stock

Interestingly, **Sun Life Financial** (TSX:SLF) stock has delivered higher returns than TD stock in the last decade. Specifically, the life and health insurance stock returned about 16.5% annually versus TD's 12.6%.

Sun Life actively manages its investment portfolio. It last reported debt securities that made up 43% of its investment portfolio. It noted that 97% of its fixed-income securities were rated investment grade, including 72% that were A-grade. In other words, it maintains a high-quality fixed-income portfolio that should benefit from a higher interest rate than a year ago. This may be why the stock is approximately 24% higher since the start of October 2022.

At $66.87 per share at writing, the dividend stock is reasonably valued and offers a dividend yield of 4.3%. Its dividend is sustainable on a payout ratio of about 47%.

Bottom line

While both stocks are likely to do better in a higher interest rate environment, TD stock provides a bit more advantage to investors based on a slightly bigger discount on the shares.

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kayng