NJMoneyHelp.com
smart advice. every day.

What Stocks Will Benefit From Higher Interest Rates?

By Karin Price Mueller | NJMoneyHelp.Com
December 16, 2016

Q. If interest rates move higher, like they say they will with Trump, which investments will benefit? — Investor

A. Interest rates are already moving higher as we saw from the announcement from the Federal Reserve earlier this week.

As rates move higher, investors need to take a hard look at their portfolios because they were probably designed to be most effective when yields were declining amid a slow-growth economic environment, said George Kiraly, a certified financial planner with LodeStar Advisory Group in Short Hills.

He said there are going to be winners and losers as the Fed begins to hike interest rates.

"Since higher interest rates most often coincide with stronger economic growth, investors should focus on those sectors that will respond to accelerating overall growth," he said.

Kiraly said consumer discretionary stocks could be among the winners. A more robust economy should lead to higher levels of consumer spending on non-essential goods and services, he said.

"When consumers are more optimistic and confident, they tend to splurge on themselves," Kiraly said. "Companies in the entertainment, travel, restaurant and retailing industries should benefit."

Financial stocks may also do well, and are usually considered the most direct beneficiaries of rising rates.

Kiraly said banks, insurance companies and brokerage firms will most likely be in a sweet spot — banks via more loan demand, insurance companies by way of higher returns earned on premiums from policyholders and brokerage companies due to greater investment activity because of stock market strength and investor enthusiasm.

Then there are technology companies, which have come to depend on corporate spending to fuel growth.

"Many are also carrying very healthy cash positions, which means the opportunity to earn more interest income," Kiraly said. "Again, rising yields generally mean that the economy is improving, which should lead to a potentially significant increase in a corporate spending."

You can also consider investing in bank loans, called floating-rate funds, because their rates are variable and adjust periodically to keep pace with short-term interest rates.

"Owners of bank loans receive a higher yield as bond yields go up with interest rates. For this reason, bank loan securities also stand to benefit as rates begin to rise," Kiraly said.

He said investors looking to own these sectors without the risk of investing in individual stocks should consider an exchange-traded fund (ETF).

Kiraly said it's not too late to lighten up on some of the interest-sensitive sectors of the market, such as utilities, telecommunications, and consumer staples. These sectors tend to underperform in a rising rate environment, he said.

He said utilities are generally the worst performers relative to the market when interest rates are on the rise.

"At my firm, we began selling a large percentage of our holdings in utilities and other interest-sensitive securities in early July of this year, just after the 10-year treasury yield hit an all-time low of 1.32 percent," he said. "It now sits at 2.52 percent, or 90 percent higher."

Investors may also want to consider a shift in their bond maturities. Kiraly said bonds with longer maturities are probably going to get hit hard as rates rise. The longer the maturity of a bond, the more potential downside and volatility you can expect.

"Owning bonds in a rising rate environment is about playing defense," he said. "You get defensive by buying shorter maturities. We've reduced most of our bond maturities from seven to 10 years, down to one to three years."

He said it makes sense for investors to take the time now, before interest rise significantly, to examine their portfolios in order to consider appropriate adjustments with the changing direction of the rate environment.

Email your questions to Ask@NJMoneyHelp.com.