# Rates on the Rise: Should Stock Investors Take Cover?

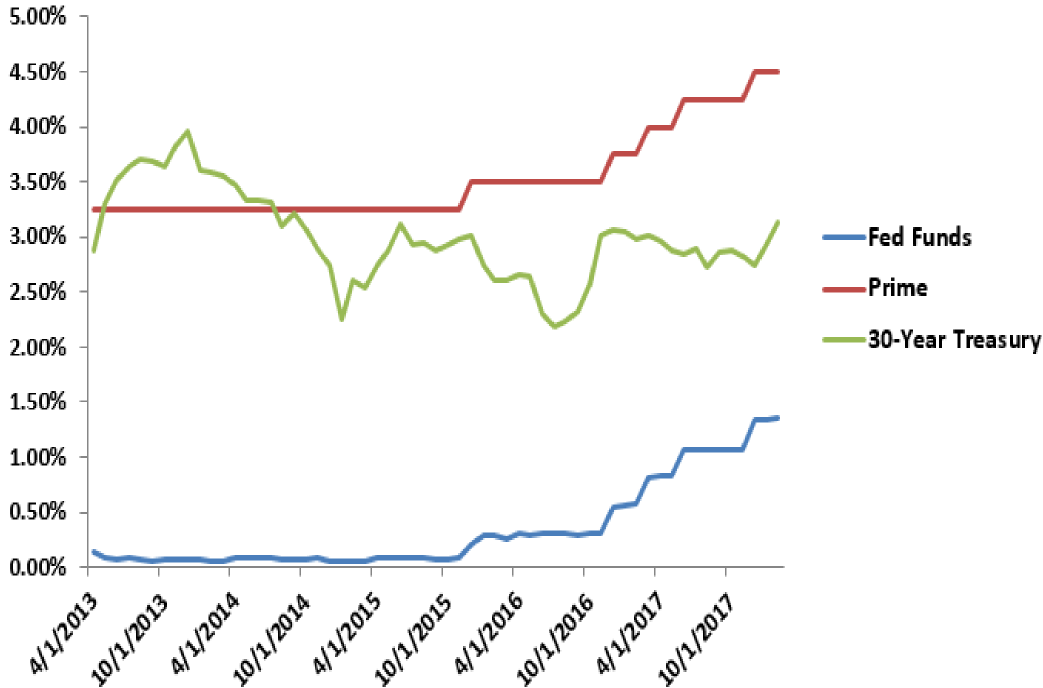
Interest rates have been edging up lately, spurred in part by boosts from the Federal Reserve. But, as history has shown, higher rates don't necessarily spell doom for stocks.

Both long- and short-term rates have spiked since the start of the year.

Don't look now, but interest rates have been creeping up. In late March, the Federal Reserve boosted interest rates for the sixth time since late 2015, bringing the target range for the federal funds rate to 1.5%-1.75%, its highest level since 2008. What's more, the Fed indicated that it anticipates additional rate hikes in 2018, and possibly steeper hikes in 2019 and 2020. Other rates -- both short and long -- have followed suit. One-year Treasuries topped 2% in March, and the rate on 30-year Treasury bonds stood at just under 3% at month-end.

The rising rate trend has been in force for a while now, pursuant to the Federal Reserve's "policy normalization" program whereby small periodic increases are made to the benchmark rate. But rates have taken a steeper climb in recent months, reflecting several developments. First, robust economic growth and the anticipated boost from the $1.5 trillion tax cut have tipped the Fed's hand toward more increases as it attempts to fend off inflation. Second, the Treasury has been binging on debt since the debt ceiling was raised in February, creating a glut of supply and putting upward pressure on yields.

**Three Key Rates Over the Past Five Years**[1]




What do the rising rates mean to investors? For bonds, rising rates mean lower prices, as bond prices are inversely related to yields. For stocks, however, the effect of rising rates is not as clear.

## Historical Trends -- A Mixed Bag

Excluding the current cycle, the Federal Reserve has initiated rate hike cycles three times over the past 25 years -- in April 1997, July 1999, and June 2004. In each of these periods, stocks experienced an immediate or near-term decline that was followed by a longer rebound.[2] Other research that looked at the past 35 years (and six rate-hiking cycles) found that stocks don't follow a straight path up or down in reaction to a rate hike. Instead, they present a mixed bag of performance. For instance, analysis reported on CNBC.com found that in two of the six cycles, stocks, as represented by the S&P 500, were lower a year after the initial rate hike. Even so, the average gain for all six periods was 2.6%. And on average, a year and a half after the first rate hike in a cycle, the market was up 14.4%.[3] Another key factor affecting the movement of stocks in relation to interest rate hikes was where in the business cycle the economy might have been when the rate increases commenced. For instance, Fidelity reports that, based on historical averages, most rate hikes have started in the middle of the business cycle when the economy is growing and corporate profits are positive. In these cases, investments have tended to produce positive returns. As the cycle matures, however, returns begin to diminish.[4]

## Takeaways for Investors

Given the likelihood of further interest rate hikes, you may be rightfully cautious in your outlook for your stock portfolio. But don't let your emotions get in the way of potential investment opportunities. Consider discussing the following strategies with your financial advisor at your next meeting.

- Consider buying on the dips. A systematic purchasing plan, also known as dollar-cost averaging, can help in volatile times, as it provides for regular purchases over a period of

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time, taking the guesswork out of specific timing of purchases.[5]
- Consider high-quality dividend stocks. Equity investors looking to limit volatility may want to consider an income-producing strategy via dividend-paying stocks. Although a company can potentially eliminate or reduce dividends at any time, a dividend may provide something in the way of a return (i.e., income) even when stock prices are volatile.
- Review sector allocations. History supports the notion that Fed actions affect equity sectors in different ways. For instance, in a restrictive cycle, defensive sectors such as utilities, energy, consumer staples, and health care have tended to perform better, as these sectors produce necessary goods and services that have less reliance on consumer discretionary spending. In an expansive cycle, leading sectors tend to be those that are more dependent on consumer spending, such as retail, apparel, autos, and construction.[6]

These are just a few of the strategies you may want to consider during a rate-hiking cycle. Work with your financial advisor to review your unique circumstances and make changes, as deemed appropriate, for your situation.

[1]Source*: Board of Governors of the Federal Reserve System, U.S. Department of the Treasury. For the five years ending March 31, 2018.*

[2]For the periods indicated. Stocks are represented by the S&P 500, an unmanaged index generally considered representative of stock market performance in the United States. Past performance does not assure future results. Investors cannot invest directly in any index, although many mutual funds closely track the performance of an index.

[3]CNBC.com and Nuveen Asset Management, "When the Fed raises rates, here's what happens," September 17, 2015.

[4]Fidelity, "First rate hike; what you need to know," September 9, 2015.

[5]Dollar-cost averaging involves regular, periodic investments in securities regardless of price levels. You should consider your financial ability to continue purchasing shares through periods of high and low prices. This plan does not assure a profit and does not protect against loss in any markets.

[6]*Forbes*, "How Rising Interest Rates Will Affect The Stock Market And Your Investments," May 19, 2015.

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