What is the Impact of Higher Interest Rates on Stock Market Multiples?

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In our last column, we discussed Quantitative Tightening ("QT") and its impact on long-term interest rates. Ray Dalio is one of the most respected investors on Wall Street. In a recent article published on Linkedin, Dalio states "…there is the supply and demand effect on interest rates that results from how much borrowing and how much lending there is. For example, the US government is going to have to sell a lot of debt to fund the deficit (4-5 percent of GDP this year) and the Federal Reserve is also going to sell (and let roll off) a lot (~4 percent of GDP). So the question is where the demand to buy this big supply (8-9 percent of GDP) will come from, or how much will interest rates have to rise to reduce private sector credit demand to balance the supply and demand. What do you think?... I think it looks like interest rates will have to rise a lot (toward the higher end of the 4.5 to 6 percent range) and a significant fall in private credit that will curtail spending. This will bring private sector credit growth down, which will bring private sector spending and, hence, the economy down with it."

Dalio is talking about QT, which refers to the selling (or allowing to roll off) of bonds currently owned by the Federal Reserve. Removing the Federal Reserve as a very large buyer of US government bonds will cause long-term interest rates to rise. If Mr. Dalio is correct and long-term rates reach levels which are substantially higher than they've been for the past decade, what are the implications for your portfolio?

Higher interest rates typically have a negative impact on stock prices. The rationale is twofold: higher rates decrease the present value of future earnings, and, higher rates make bonds more attractive which reduces demand for stocks. There are, however, specific sectors which tend to outperform in higher interest rate environments.

Please call one of our advisors to discuss how your portfolio can benefit from higher interest rates.

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