

# E1 Asset Management Ask: How Rising Interest Rates Will Affect the Stock Market

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/EINPresswire.com/ -- Amid rapidly increasing inflation worries, the Federal Reserve announced last week its plan to raise interest rates three times in 2022. The first-rate hike could come [as soon as March](#). Although the move to raise interest rates will help bring inflation in line, many investors are concerned about how higher rates could affect their portfolios. Here's what investors need to know about how higher interest rates impact the stock market and what to expect going into 2022.



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## How Stocks Respond to Higher Interest Rates

Typically, rising interest rates impede stock market growth because higher borrowing costs cause businesses and consumers to spend less. This decreased spending can include less hiring, lower productivity and reduced earnings. In turn, these effects generally cause stock prices to fall or plateau.

Another important consideration is that small changes in interest rates can have outsized effects on share prices. This outcome happens because most of any given stock's price is [based on terminal value](#), or value for the period beyond which earnings can be reliably predicted. When the price of borrowing rises, the long-term costs to companies go up significantly and reduce the projected terminal values of stocks.

## Could 2022 Be the Exception?

Although rising interest rates exert downward pressure on stock prices, many other factors are involved. With the US and global economies currently amid solid recoveries that support higher share prices, the fourth quarter is now expected to see economic growth far ahead of what economists had projected. In addition, the US may also be approaching full employment, suggesting that lower interest rates are no longer needed to boost hiring.

Consider as well that interest rates have been held near zero in recent years. Even with the coming rate hikes, US interest rates will remain relatively low by historical standards. According to an analysis by investment giant BlackRock, stock prices have historically been more likely to rise than fall when interest rates increase from abnormally low levels. If this trend holds true, the three interest rate hikes in 2022 are unlikely to affect share prices substantially.

### What to Expect From the Stock Market Next Year

Given the uncertainty of how rate hikes will affect stock prices, there are several possible outcomes for 2022. First, some analysts, including those at Morgan Stanley, predict a continuation of high growth levels, even as interest rates rise. Ongoing growth would be consistent with BlackRock's findings regarding hikes in low interest rate environments, especially if the rate hikes are each fairly small. In addition, some interest rate increases are likely already priced into the market, reducing the chance of sudden price drops.

Another school of thought, however, takes the more traditional view. Under this model, stocks would plateau and [remain largely flat throughout 2022](#) as growth leveled off and interest rates rose. This model is more consistent with the prevailing view of an inverse relationship between stock prices and interest rates.

Yet another projection suggests that stock prices will slump off long after the rate hikes go into effect. Drawing on data from historic rate hike cycles, analysts at Deutsche Bank believe that stock prices could continue to rise for approximately 10 months after the first increase. If this model is correct, stock prices won't begin to lag until early in 2023.

### How to Shield Your Portfolio From Interest Rate Hikes

While no one can predict exactly what will happen when interest rates rise, some strategies may help investors insulate their portfolios. One such approach is finding companies that stand to benefit from the higher rates. For example, utility stocks tend to underperform when rates rise, but industries that profit from interest on loans can still do quite well. Finance stocks, for instance, tend to be well-positioned to take advantage of higher interest rates.

Investors can also adjust their bond holdings to guard against high-interest rates. A blend of corporate and government bonds will help you ride out the storm of higher rates. If investors' fixed-income investments are in funds, take a look at the composition of those funds to be sure they are properly diversified.

Finally, investors should consider divesting from assets used as inflation hedges. Tangible assets, most notably gold, are useful hedges against rapid inflation. However, these assets tend to perform poorly when interest rates rise. Selling off some of their inflation hedges and allocating the capital to other assets can help their portfolio as a whole maintain its performance in a high-interest rate environment.

The Federal Reserve's move to raise interest rates in 2022 may be unwelcome news for the stock

market, but there are still opportunities out there for investors. Above all else, be sure to keep putting money into their investment portfolio regularly. The simple strategy of dollar-cost averaging is a great way to build wealth over the long run, even if short-term price dips or plateaus occur. Remaining consistent with their investing will allow investors to ride out the temporary impacts of higher interest rates in 2022 and beyond.

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