3 Places to Invest as Interest Rates Head South

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With interest rates heading to zero, keeping your money in the bank has become a poor way to increase – or even preserve – your wealth. A better strategy, I believe, is a well-chosen portfolio of stocks. In this blog, I highlight three types of businesses that should provide compelling returns in the years to come.

It is relatively easy to consider how an investor rationally responds to declining rates – they look for better returns elsewhere. If rates on your term deposit went negative and it was costing you money to keep your money in the bank, would you leave it there? The answer is that you would look for alternatives, starting with the most liquid.

The most liquid alternative is probably the stock market – you can change your mind and usually exit immediately. Such liquidity is unavailable in tangible assets such as property and even less so in non-income producing assets such as collectibles.

But the stock market has its own set of risks and with interest rates now declining for almost 40 years, stocks are potentially so expensive they offer very little in the way of future potential returns.

A simple rule to remember when it comes to investing is: the higher the price you pay, the lower your return. As interest rates have declined, investors have progressively migrated into stocks pushing their prices higher. Consequently, investors are now buying long duration assets and locking in those lower returns.

Businesses with structural tailwinds

Having said that, there are businesses that are growing structurally. These are businesses that were growing before the pandemic hit and in many cases their trends in growth have accelerated as governments, through fiscal support packages and restrictions on movement, forced businesses and consumers to adapt.

Data warehouses are an example of structurally growing businesses. The ongoing shift to e-commerce, the advent of cloud computing and the emergence of music and video streaming means demand for data storage and access is growing at multiples of the rates experienced by the broader economy. It should also be noted that demand for data is where demand for smart phones, laptops and digital music was years, if not decades, ago. The risk of underestimating the length of the runway for growth is very high.

Businesses leveraged to an economic recovery

The other kind of businesses worth examining are those leveraged to a recovery in the economy as a vaccine gets closer or a treatment or more accurate rapid testing is developed. These are the businesses hit hardest by the sudden economic stop and the businesses that will respond with the most furious recovery. The share prices of some of these businesses could jump 40-50 per cent on the announcement of a vaccine.

Travel agents, cruise lines, airlines and airports are businesses that fit in this category. Even a business like Tyro, which owns more than 64,000 paywave merchant terminals operated by some 35,000 merchants in Australia (typically bars, clubs and cafes), could see growth rates head towards 2019 levels if the economy moves towards normal activity levels. The other advantage of these companies is that their depressed share prices offer some element of value. In a world where value stocks have underperformed growth stocks by the greatest extent in history, some exposure to these stocks provides leverage to a possible mean-reversion between growth and value.

Businesses that benefit from a stronger AUD

The third category to consider are businesses that benefit from a stronger Australian dollar. Consumer retailers fit here. If rates in Europe head lower and the US fails in its attempt to control the virus's spread, lower or even negative rates could see international flows head to the relative security of Australia. In such a scenario, would retailers benefit from cheaper import prices. And if borders remain closed, domestic travel, including camping holidays and road trips, would mean retailers selling camping and leisure equipment could surprise with their rates of growth.

Equities are not without risk but a carefully tuned portfolio of quality businesses exposed to the right tailwinds should ensure investors do better, in the long run, than the 0.60 per cent on offer with term deposits.