



And now for something completely different

[Andrew Allentuck](#)

Capital markets tend to go into a feeding frenzy when there is a prospect for a decline in interest rates or even a good chance that they will stabilize. That's not surprising. After all, the sector is about selling money and, when the cost of that money appears to be falling or even just turning predictable, the scent of rising profits attracts investors. The value of future cash flows rises or steadies and the predictability of returns brings more money to the table, says John Hadwen, a portfolio manager at Goldman & Company in Toronto.

Financial services used to be a trinity of banking, insurance and wealth management, says Richard Howson, executive vice-president and chief investment officer of Howson Tattersall Investment Counsel Ltd. in Toronto. Today, however, the sector is about a lot more. As Chris Lowe, senior vice-president of AIC Investment Services Inc. in Burlington, Ontario, explains, financial services now include global securities custodians, securities exchanges, financial networks and debit processors, insurance brokers and financial information providers. Several of their picks are included in the list of alternative financials in the accompanying box.

"Infrastructure financials are a variation on the typical company in the sector that takes on credit risk.," explains James Dancy, vice-president of AIC Limited in Burlington, Ontario. He adds that AIC plans to launch its Copernican Fund at the end of July with a portfolio of global financial infrastructure companies.

In the stew of traditional and newly recognized financial services, banks are less interesting than these alternative financial services, many of which do not have lenders' huge appetite for capital. Moreover, the newcomers could produce more market action if worries about rising interest rates subside.

There are also technical reasons to think that domestic chartered banks will not lead financial services when interest rates begin to decline. "Canadian banks have done relatively well during the period of rising rates," Mr. Lowe explains. On the theory that what falls will bounce back, he suggests that "interest rate declines may not help banks as much as other financial services."

Even if bank earnings strengthen when rates decline, the effect could be transitory, explains Dan Bain, President and Chief Investment Officer of Thornmark Asset Management Inc. in Toronto. The effect is temporary, however, for the falling cost of money produced by a rate drop eventually moves into balance with lower returns for lending it. Thus interest-driven profit gains for banks are less a growth story than a cyclical phenomenon, he adds.

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In a stable or declining interest rate environment, fund managers like IGM Financial and CI Financial should thrive at least as well as banks, Mr. Bain says. Investors flock to equity funds that generate more income for fund managers than do bond funds, he explains.

There is an even stronger driver for the popularity of fund management companies - the trend to turn them into income trusts, as CI has recently done under its new structure and moniker, CI Financial Income Fund. What's more, mutual funds that buy income trusts will thrive and attract money to fund managers in a stable or declining interest rate environment, Mr. Bain says.

The investor who times purchases of financial services stocks should be temperate in his expectations says Pat McKeough, a portfolio manager who also publishes *The Successful Investor*, a widely read and respected market advisory letter. He argues that in a climate of relatively moderate, single digit interest rates, the power of a rate decrease is far less than it would be if rates were in double digits and poised to fall. That's all the more reason to search beyond cyclical plays for alternative services that could thrive in the expanding global financial services market

Non-bank financials:

Life insurance companies:

[Manulife Financial Corporation](#): highly respected management, strong Asian growth, steady growth, diversified products, strong earnings and revenue gains. Widely regarded as Canada's premier lifeco.

[Sun Life Financial Inc.](#): strong position in fund management through large stake in CI Financial Income Fund, somewhat weaker market performance.

Wealth Managers:

[IGM Financial Inc.](#): operates Investors Group in Winnipeg and Mackenzie Financial Services in Toronto. A giant of the wealth management industry

CI Financial Income Fund: spectacular growth of revenue and earnings over the last three years, recently converted to an income fund

Payment networks:

[American Express Company](#): the giant of travel services, payment networks and cash storage devices like travelers cheques, is regarded as having strong growth potential in payments networks in Europe and Asia.

Financial information providers:

[Thomson Corporation](#): based in Stamford, Connecticut, provides data services in finance, law and other fields in 130 countries. Operates in U.S. dollars and therefore has seemed a laggard in Canadian dollar terms in spite of its rapidly growing asset base.

Stock markets:

[TSX Group](#): owns the Toronto Stock Exchange and has generated strong growth of revenue and

earnings

Deutsche Borse: Frankfurt-based German stock and derivatives market with clearing and settlement business; trades at attractive multiples well below those of other global equity markets

Custodians:

[Bank of New York](#): the world's largest global custodian and operator of a major global payments network. Strong growth of revenues and profits.

Land title insurers:

[First American Corp.](#): San Francisco-based provider of mortgage tracking and credit information and title insurance; company has strong revenue and earnings growth. Has recently sold off as interest rates have risen and crimped the housing market in the United States. This is a play on a pickup in the housing market revival anticipated when interest rates decline.

Global asset managers:

[Credit Suisse](#) and [UBS](#): Zurich-based universal banks active in private wealth management.

Andrew Allentuck writes about investments for *The Globe and Mail*, and reviews books on finance for [globefund.com](#) and [globeinvestor.com](#). He is also the author of several books.

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