

The Canadian Banks – So Hot Right Now

Description

The S&P/TSX Composite Index managed to eke out a gain over the course of Wednesday morning thanks in large part to the Financials sector. More specifically, the Canadian banks. **Royal Bank (TSX:RY)** and **Scotiabank (TSX:BNS)** were the two largest positive contributors to the Index's return through the morning.

This performance continues a strong run for all the Canadian banks as illustrated in the table below. While the S&P/TSX Composite is pressing up against its 52 week high, so too are the banks. In addition, the 6 month returns for the group have, for the most part, dominated the broad index.

Company	Current	52 wk high	% of high	6 mth rtn	Div yield
Royal Bank (TSX:RY)	\$62.81	\$62.86	99.9%	19.7%	3.8%
CIBC (TSX:CIBC)	\$82.60	\$84.33	97.9%	12.1%	4.6%
Scotia (TSX:BNS)	\$59.01	\$59.20	99.7%	11.4%	3.9%
BMO (TSX:BMO)	\$62.86	\$64.70	97.2%	8.5%	4.6%
TD (TSX:TD)	\$83.10	\$85.85	96.8%	4.4%	3.7%
Average			98.3%	11.2%	4.1%
S&P TSX Composite	12,774.96	12,830.60	99.6%	7.4%	3.0%

Source: Capital IQ

The banks may continue to roll for a number of fundamental reasons:

- Bond yields are creeping higher.
- Foreign divisions offer potential earnings growth.
- Improving investor sentiment may drive wealth management and capital markets divisions.
- Loan losses remain benign.

Another reason for this market beating performance to continue, at least for the next couple of weeks, is that it is RRSP season here in Canada. For the reasons provided above, plus the banks continue to

offer superior dividends that feed the dominant income theme, is there an easier sell in the market right now for a broker to make to their client?

Whoa there buckaroo!

Something to consider before rushing on to the bank bandwagon is valuation. Based on a quick and dirty relative comparison in the table below of current book value multiples to the average over the past 10 years, banks could be considered very close to fully valued. This doesn't mean that the run needs to stop, but it could indicate that there isn't much near term upside left.

Company	P/B	10 yr avg	% of avg
Royal Bank	2.3	2.5	92.3%
CIBC	2.2	2.4	92.9%
TD	1.7	2.0	84.3%
Scotia	2.0	2.4	80.7%
BMO	1.6	1.9	80.7%
Average	1.9	2.3	86.5%

Source: Capital IQ

The Foolish Bottom Line

The Canadian banks are some of the greatest businesses in the world and have made investors in this country piles of money over the years. Historically, it has been nearly impossible to lose money on this group if you simply held on over the long-term. This being said, banking is cyclical and these companies do occasionally slip up.

A potential hiccup looms as Canadians have accumulated sizeable personal debt and our housing market has been on a steadily appreciating tear. Both of these dynamics have helped provide a significant tailwind for the banks over the past decade. Should either take a turn, growing the domestic business is going to be a challenge. With valuations as full as they are, a turn could lead to a pull-back for the stocks. Rather than rushing in, this pull-back may offer investors a much more appealing opportunity to fill up their portfolio with these financial giants.

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Fool contributor Iain Butler does not own shares in any of the companies mentioned in this report at this time. The Motley Fool has no positions in the stocks mentioned above.

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1. Investing

TICKERS GLOBAL

1. TSX:BMO (Bank Of Montreal)
2. TSX:BNS (Bank Of Nova Scotia)
3. TSX:CM (Canadian Imperial Bank of Commerce)
4. TSX:RY (Royal Bank of Canada)
5. TSX:TD (The Toronto-Dominion Bank)

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