



Bank of Nova Scotia Earnings: Keep Your Eye on This Emerging Trend

Description

This morning, **The Bank of Nova Scotia** (TSX:BNS,NYSE:BNS) made it three of three Canadian banks that have reported results that are worthy of little more than a shoulder shrug, for now.

The bank's adjusted EPS in the quarter measured \$1.24 vs. consensus at \$1.26 and last year's Q2/12 EPS of \$1.16.

6.9% year-over-year EPS growth looks good, but there is one figure to keep an eye on that indicates that the bank may not be able to keep this rate up.

For all the banks, domestic lending is in my mind the key metric to monitor given the consumer debt profile that has emerged in this country, as well as the state of our housing market.

Scotia showed that domestic earnings were up 18.7% year-over-year. Impressive, but wind-aided by the bank's acquisition of ING Direct. The disturbing figure was quarter-over-quarter domestic banking earnings growth. It showed a decline of 4.7%, which could add fuel to the fire that overall Canadian domestic lending is slowing. [TD \(TSX:TD,NYSE:TD\) demonstrated a similar trend in its report last week.](#)

In addition, the return on equity (ROE) earned by the domestic operation has also taken a hit. In Q2/12, this figure stood at 38.3%. The most recent reading was 34.6%, which is down from 36.3% at the end of Q1/13. This is still an eye-popping ROE, and the ING Direct acquisition had an impact here, but, the trend is disturbing.

Foolish Takeaway

Relative to some of the other banks, Scotia is relatively insulated from a slow-down in domestic lending. BNS earned \$471 million during the second quarter from its international operations, just shy of the \$76 million it earned from its domestic bank. However, the bank's multiple will take a hit if earnings from its domestic operations continue to decline, bringing ROE down with them. This means significant capital appreciation from this name, as well as its Canadian peers, is likely to be capped for some time.

Because of their significant weight in the S&P/TSX Composite Index, a lack of capital appreciation from the banks means the Canadian market could be stalled, making passive Canadian index investors vulnerable to disappointing returns in the coming years.

We have prepared a [Special FREE Report](#) that will clue you into the perils of investing in the Canadian index and suggests an easy to implement alternative strategy. It's called "**5 Stocks That Should Replace Your Canadian Index Fund**" and you can receive a copy at no charge – just by [clicking here](#).

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Fool contributor Iain Butler does not own shares of any of the companies mentioned at this time. The Motley Fool doesn't own shares in any of the companies mentioned.

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2. TSX:BNS (Bank Of Nova Scotia)

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