Why Bank of America Says You Should Bet Against Canada's Banks

Description

With so many worries surrounding Canada and its economy, there is obviously a dark cloud hanging over the banks.

In fact, **Bank of America** chief investment strategist Michael Harnett is recommending shorting (betting against) the Canadian banks. It is Mr. Harnett's number two trade for 2015, as reported by *The Globe and Mail*. So why is Mr. Harnett so pessimistic about our banks?

A combination of factors

The main reason for Mr. Harnett's pessimism is the crash in energy prices. And it's easy to see why. The fall in prices is putting all producers under serious pressure, and some companies undoubtedly will not be able to cope. This will lead to loan losses for these companies' lenders, including the banks. And that's only the beginning.

As producers dial back expansion plans, employees may find themselves out of work. Real estate markets in energy-producing regions could slump. Canada's economy could suffer. All of this would lead to lower demand for loans, as well as higher defaults.

Making matters worse, if the oil rout continues, then producers' stock prices will continue to plummet. And that would be bad news for the banks' Capital Markets and Wealth Management divisions.

Meanwhile, the American economy is roaring along. Economic growth is strong. Employment numbers look good too. And lower gas prices are putting more money in consumers' pockets.

A difference in prices too

Instead of buying the Canadian banks, Mr. Harnett advises buying the American ones. And there's a strong case to make for that strategy. Not only do these banks face a rosier outlook, their shares are cheaper too. To illustrate, the Canadian banks are currently trading around two times book value while BofA is trading for less than one time book value. Other American banks are trading just as cheaply.

So what should you do?

First of all, you should be very careful. In other words, don't make an oversized bet on the Canadian banks. But there are still a couple of banks in particular worth owning.

One is **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), Canada's second largest bank. It has relatively little exposure to the oil sector, has very little focus on Capital Markets, and has a big presence in the United States too. Best of all, TD's share price has gotten a lot cheaper, thanks to a 9% fall since late November.

Another is **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), which is less exposed to Canada than any other Canadian bank. Its stock price is also relatively cheap, after having badly trailed its peers over the past year. This looks like an opportunity to buy the dip.

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