Should You Sell the Canadian Banks?

Description

The news keeps getting worse for Canada's banks.

Last year, there were growing concerns about the Canadian housing market, as well as the highly indebted Canadian consumer. These concerns only grew as the price of oil plunged. The CEO of **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) recently acknowledged that 2015 would be a tough year.

Fast forward to Wednesday, and the Bank of Canada has shocked investors by cutting the overnight rate from 1% to 0.75%. Governor Stephen Poloz called it an "insurance policy" against future risks. As a result, the Canadian dollar is crashing.

So why is an interest rate cut bad for the banks? And does this mean you should sell these companies' shares? Below we take a look.

A focus on net interest margins

When banks lend money, they charge a higher interest rate than they pay to depositors. The difference between these two rates is the "net interest margin", and it is the main way that banks make money.

In recent years, with interest rates so low, net interest margins have also been depressed. This is because the banks have been forced to lower the interest rate it charges to borrowers. Deposit rates aren't affected as much, because they are so low anyway. Wednesday's announcement could eventually send margins even lower.

There is some good news. Banks have plenty of longer term loans outstanding, with fixed interest rates. And the announcement does not change the rate on these loans. So it will take some time before the banks feel the full brunt of this announcement.

So what should you do?

I know there's a lot going against the banks right now. But there are two you should consider holding for your portfolio.

One is TD. The bank has a very big presence in the United States (it actually has more branches there than it does in Canada), and the American economy is performing very well. TD also has little exposure to the energy sector, and may even benefit from oil's fall, thanks to its presence in the United States and Ontario. Best of all, the bank has a fantastic track record, and a depressed share price.

The other is **The Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS). The company is Canada's most international bank, and is thus not as exposed to Canada as its peers. It also has promising growth prospects in countries like Mexico, Colombia, Peru and Chile. And like TD, The Bank of Nova Scotia has a fairly depressed share price, currently at about 11 times earnings.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:BNS (Bank Of Nova Scotia)
4. TSX:TD (The Toronto-Dominion Bank)

Category

1. Bank Stocks
2. Investing

Date
2025/07/22
Date Created
2015/01/22
Author
bensinclair