3 Reasons to Sell the Canadian Banks Today

Description

It’s been a great run for Canada’s big five banks. Fuelled by a consistently hot housing market, Canadians’ appetite for loans, and solid execution, many of the banks have been posting record profits.

But the future is not looking so bright for the banks, and share prices could suffer as a result. On that note, below we look at three reasons the banks will struggle in 2015.

1. An overpriced housing market

You must be tired of hearing this by now. But most experts agree that Canada’s housing market is overvalued, and that a correction is long overdue. Making matters worse, household debt is at record levels, having climbed to 162.6% of disposable income in the third quarter of last year.

The good news is that the banks have solid risk controls in place, so we’re very unlikely to see heavy debt losses. But a correction would surely lead to slower loan growth. If house prices fall, Canadians wouldn’t have to borrow so much to buy a new home (and would be less likely to want a mortgage anyway). If the correction were steep enough, then the broader economy would be affected. Home builders and contractors would struggle, and perhaps default on loans. Stock prices could get hammered. All of this would be bad for the banks.

This risk should be especially concerning for **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM). The bank has dedicated itself to the Canadian market, to the point where Canada accounts for over 90% of net loans.

2. Low oil prices and the Canadian economy

When Bank of Canada governor Stephen Poloz lowered interest rates last week, he called low oil prices “unambiguously negative” for the Canadian economy. And while those words may have been a bit strong, the oil plunge raises some legitimate concerns for the banks.

First of all, energy companies may start defaulting on loans. Secondly, the economy of Alberta is getting hit hard, affecting the real estate market in places like Calgary. And Alberta’s problems will be a drag on the rest of Canada — for instance, the federal government will have a tough time balancing its budget.

This should all be particularly concerning for **Royal Bank of Canada** (TSX:RY)(NYSE:RY), the bank most exposed to the energy sector. Approximately 8.5% of corporate loans are made to energy companies, and its Capital Markets business specializes in the energy sector too.

Toronto-Dominion Bank (TSX:TD)(NYSE:TD) will be less affected. Energy loans account for less than 4% of corporate loans, and the bank is much more retail-focused anyways.

3. Low interest rates

Thanks to lower interest rates, the banks have already started lowering mortgage rates, and sooner or later should lower the prime rate too. This will inevitably squeeze margins.

If you're still looking to own a bank, then either TD or **The Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS). The latter is Canada's most international bank, with less than 60% of net income coming from Canada. It also has a depressed share price, mainly because its shares have lagged its peers over the past year.

If you're looking for more information on the Canadian banks, be sure to check out the free report below.

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