Why You Should Trade Your Canadian Bank Shares for the American Banks

Description

The big five banks have long been staples in so many Canadians' portfolios. And that's a very good thing. Just look at **Royal Bank of Canada** (TSX:RY)(NYSE:RY), whose shares have returned 13.7% per year over the past 15 years.

Meanwhile, the American banks have made for far worse investments. The industry is far more competitive south of the border, making profits harder to come by. Many banks acted recklessly leading up to the financial crisis and got crushed as a result. More recently, growing regulations, fines, and litigation costs have hampered the banks. **Bank of America Corp** (NYSE:BAC) is a perfect example. Its shares have only returned 2% per year over the last 15 years — and many other banks have fared worse.

That said, now seems like a great opportunity to sell the Canadian banks for the American ones. Below we show you why, using Royal Bank of Canada (RBC) and Bank of America (BofA) as examples.

The problem with Canadian banks

The Canadian economy has performed very well for a long time, but today there are some serious dark clouds on the horizon. The real estate market seems overvalued by any reasonable measure and is overdue for a correction. Meanwhile, Canadians are very heavily indebted — in fact, a new McKinsey study identified Canada as one of seven countries with "potential vulnerabilities" as a result of high household debt.

Making matters worse, the oil price plunge could cause some real headaches. Energy companies could start defaulting on loans. The Calgary real estate market is plunging. Governments — both in Alberta and in Ottawa — are facing big budget deficits. All of this could have negative implications for a bank like RBC. Making matters worse, the Bank of Canada has cut its benchmark interest rate, which further narrows the Canadian banks' margins.

And there are a couple of reasons to dislike RBC in particular. It arguably has more exposure to the energy sector than any other big five banks. Second, its share price is still very healthy, trading at 2.2 times book value. So if the Canadian economy continues to struggle, there's plenty of downside for RBC's shares.

Why you should own American banks instead

It's true that BofA hasn't made a great investment over the years. Back in 2006, the shares traded above US$50, well above today's US$16. So why would you want to own this stock?

Well, first of all, the American economy is firing on all cylinders. Growth is strong, unemployment is falling, and the oil price plunge is a net positive for the country. All of this is making banks very hopeful.

Yet at the same time, bank shares are still very depressed — for example, BofA trades at only 0.8

times book value. Jack Hough of *Barron's* has said the company could easily make $2 per share by 2017, not bad for a $16 stock. In any case, there seems to be more upside than downside for American bank stocks. The same can't be said for Canada's banks.

But you shouldn't stop there. American stocks look much more promising than Canadian ones at this point. Below you'll find three more names from south of the border to add to your portfolio.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:BAC (Bank of America)
2. NYSE:RY (Royal Bank of Canada)
3. TSX:RY (Royal Bank of Canada)

Category

1. Bank Stocks
2. Investing

Date
2025/07/03
Date Created
2015/02/05
Author
bensinclair