Buy Bank of Nova Scotia Despite Recent Short-Term Headwinds

Description

Growing concerns over Canada's slowing economy and **Bank of Nova Scotia's** (TSX:BNS)(NYSE:BNS) exposure to the troubled energy patch has hit the bank hard. These factors and the recent market correction triggered a sell-off of the bank, which is down by just over 12% for the year to date.

While there are a range of looming headwinds that have the potential to impact Bank of Nova Scotia's short-term performance, I believe that it now represents an attractively priced long-term buy.

Now what?

A weak Canadian economy and low interest rates have the potential to reduce Bank of Nova Scotia's profitability. As unemployment rises and consumer sentiment declines, credit growth will fall because of consumers holding off on major purchases. The end result will be a decline in Canadian credit growth, a core profit driver for the bank.

Another issue is that the current low interest rate environment, coupled with speculation that the Bank of Canada will cut rates again, is applying pressure to its net interest margin, a key measure of profitability.

Then there are concerns over the quality of Bank of Nova Scotia's credit portfolio. Impaired loans for the bank's third quarter jumped sharply year over year, rising by almost 12% in value. This can be attributed to weak crude prices that are playing havoc with the energy patch, causing many oil companies to struggle with meeting their financial obligations.

As a result, the bank's impaired loans for oil and gas companies for that period more than doubled and, with the outlook for crude remaining bleak, this number can only continue to rise in the foreseeable future.

There are also concerns that a number of the emerging markets in which Bank of Nova Scotia operates will see their economies suffer because of the collapse in commodities. Countries such as Colombia, Peru, Mexico and Chile, where Bank of Nova Scotia has a significant presence, are highly dependent upon commodities including oil, copper, and precious metal as a means of driving economic growth.

However, so far none of those countries have suffered from a precipitous financial collapse because of low-priced commodities. In fact, this has worked in the bank's favour by triggering a sharp devaluation of their currencies, with markedly weaker local currencies reducing overall operating costs in Latin America.

Bank of Nova Scotia also benefited from solid loan growth and higher fee income in those markets during the quarter, indicating that weak commodity prices are not affecting economic growth.

As a result, net income for international banking for that quarter shot up by an impressive 10%.

Despite the headwinds the bank is facing, management continues to express their confidence that Bank of Nova Scotia will hike the dividend yet again. The annual dividend increased by a healthy 6% year over year and is the fifth straight year of having its dividend increase.

So what?

It is easy to malign the outlook for Bank of Nova Scotia, but, despite the headwinds it is facing, it turned in a remarkable result for its third quarter 2015 and I expect this to continue.

The bank bit the bullet at the end of 2014 and wrote down the value of a number of poor quality assets, while focusing on generating greater efficiencies in its operations. As a result, management has a good handle on costs. The bank remains well positioned to benefit over the long term from its exposure to Latin America, one of the fastest-growing economic regions globally.

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2. TSX:BNS (Bank Of Nova Scotia)

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mattdsmith