Why Now May Be the Time to Buy Canadian Banks

Description

Over the past 12 months the Canadian banks have gone increasingly out of favour, and it's easy to see why. The Canadian economy is struggling, consumers are heavily indebted, and low interest rates are squeezing lending margins.

As a result, the banks remain among the most heavily shorted names in all of Canada. **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) is the second-most shorted name on the entire TSX, while **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) sits in fifth place.

But every short seller is a future buyer, so if sentiment around the banks shifts, then there is a lot of upside for these stocks. This trend has already shown signs of life thanks mainly to a rebound in commodity prices, but we may still be in the early innings.

With that in mind, we'll take a look at the opportunities and risks in the shares of TD and Bank of Nova Scotia.

TD

It's quite strange that TD Bank is so popular among shorts, because it is probably the safest among the Big Five banks. TD has relatively little exposure to the energy sector and minimal exposure in Canada's oil-producing regions. Furthermore, the bank is heavily concentrated in areas that benefit from low oil prices, such as Ontario and the U.S. East Coast.

TD also derives over 90% of its profit from retail banking, which is a much lower-risk business than Capital Markets. And to top it all off, TD places a very strong emphasis on risk management, something that helped it tremendously during the financial crisis.

There's one slight downside to TD: at 13 times earnings, the bank is slightly more expensive than its peers. But given the bank's low-risk profile as well as its strong track record, this premium is worth paying for.

Bank of Nova Scotia

Bank of Nova Scotia is Canada's most international bank, and this is the main theme behind the company's risks and opportunities. To be more specific, Bank of Nova Scotia's international efforts focus on four countries in Latin America: Mexico, Colombia, Peru, and Chile.

All four of these countries have grown at healthy rates over the past decade, and there remains a large unbanked population in each nation. So there is plenty of room for Bank of Nova Scotia to grow. But at the same time, each nation comes with its own risks. Chile and Peru are big copper exporters, which does not bode well in today's commodity environment. Meanwhile, Colombia and Mexico each have a lot of oil.

As a result, Bank of Nova Scotia's exposure to oil and other commodities is not insignificant. And the bank hasn't had to deal with any major crises for a long time, which means there's a risk of complacency.

But here's the good news: despite a recent rally, Bank of Nova Scotia trades at just 11 times earnings. So even if the bank suffers some defaults on oil and gas loans or faces slowing growth in Chile, the downside is likely priced in already.

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Date
2025/08/12
Date Created
2016/03/14
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