What Bank Earnings and Reactions Tell Us About the Economy

Description

Over the past several weeks, the Canadian banks have released their quarterly earnings to close out the year. While most exceeded expectations and some banks increased dividends, many of these institutions failed to experience substantial increases in value.

In the case of **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), shares rose to a 52-week high following an earnings beat and an increase in the dividend, but they have failed to sustain the momentum. Since the earnings release, shares have remained relatively flat. It is important to note many of Canada's major financial institutions were already trading at or near 52-week highs.

Shares of **Bank of Montreal** (TSX:BMO)(NYSE:BMO) have traded up slightly since exceeding earnings in the most recent quarter. Additionally, Bank of Montreal has followed of earnings with an announcement to execute a share-buyback program. On the same day, shares of **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) declined in value after failing to wow investors.

What's happening?

Given the recent earnings releases and market reactions, it is clear the market is reaching a point of higher expectations which can't be beat. In the past, investors have experienced these kinds of cycles; the ending is all too familiar. Eventually, the expectations, along with the earnings multiples, are simply too great that companies can't clear the bar.

Although, in this case, investors are seeing momentum run out of the financials sector, the truth is that the banking sector may be viewed as a leading indicator to gauge the rest of the economy. As at least one of the banks has increased their loan loss provisions, the reality is, without a continued increase in lending, the message sent to the rest of the market is that of a slowdown.

With shares of **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) currently yielding less than 3.5% and **Royal Bank of Canada** (TSX:RY)(NYSE:RY) offering only a little more than 3.5%, the action that should be taken by shareholders is obvious: sell!

When evaluating the question, "What am I giving (paying) and what am I getting?", the answer becomes obvious to some investors, but clearly not all investors. At current levels, shares of Canada's biggest financial institutions may not be providing the excellent returns that have been available in the past.

Arguably, the only opportunity for a resurgence in today's market are shares in **Canadian Western Bank** (TSX:CWB), which is one of Canada's smallest banks operating exclusively in western Canada. It currently yields close to 3%, so investors have the opportunity to purchase shares in a company trading at 1.2 times tangible book value. The upside is, the company is smack dab in the middle of the oil patch which, after the past two years, may be primed for a comeback.

As an investor, it is important to look for companies with proven track records of profitability in addition to the potential to grow earnings in the future. Looking at Canada's banks, there may be only one diamond in the rough.

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