3 Reasons Canadian Banks Remain Must-Own Stocks

Description

The S&P/TSX Index has had a less-than stellar start to 2018. In January, the Index fell 1.59%. Telecommunications stocks, real estate stocks, and utilities have all experienced downward pressure in the wake of an early interest rate hike from the Bank of Canada. Canadian energy stocks have also sputtered, even with oil prices reaching two-year highs. Even red-hot cannabis stocks cooled off in the final weeks of January.

In spite of this rocky start, Canadian banks stocks look as attractive as ever. Let's go over a few reasons why investors should think about pouring some of the profits from the previous few months into sturdy Canadian bank stocks.

Rising interest rates

As we have witnessed in early 2018, some of the most reliable dividend-yielding vehicles, like utility, real estate, and telecom stocks, have been battered by the tightening rate environment. However, the big Canadian banks remain attractive options, even for those chasing yields.

There is the correlation that higher interest rates have with an improving economy, which usually leads to stronger activity for the largest Canadian financial institutions. Perhaps more enticing is the improving loan margins banks will benefit from as rates rise. Canadian banks have been lending in a record-low interest rate environment since 2009. New mortgage rules introduced by the OSFI in January are also expected to boost retention rates for major lenders.

The Canadian economy continues to impress

The International Monetary Fund increased its global growth forecast prior to the World Economic Forum in Davos, Switzerland. It now expects global growth to reach 3.9% in 2018 and 2019. It also raised its projections for Canada's economic growth to 2.3% in 2018 and 2% in 2019. The improving global economy has led to a major boom for commodities.

Canada added 79,000 jobs in December 2017, which pushed the unemployment rate to its lowest level since 1976. Alberta and Quebec posted the strongest growth — adding more than 26,000 jobs each.

The Canadian dollar has also strengthened on rising rates and U.S. dollar weakness. The inflation rate in Canada reached 2.1% in November, blowing past Bank of Canada’s expectations.

First look at U.S. tax reform

The Tax Cuts and Jobs Act that was signed into law by the Trump administration will slash corporate taxes from 35% to 21%. Canadian banks like **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), **Bank of Montreal** (TSX:BMO)(NYSE:BMO), and **Royal Bank of Canada** (TSX:RY)(NYSE:RY) all have significant footprints in the U.S.

In early January, TD Bank released a statement on U.S. tax reform. The bank estimated that it would incur a one-time impact from tax reform of approximately $400 million. The one-time charge is projected to reduce its CETI ratio by nine basis points. TD Bank pointed out that the lower corporate rate would have a positive impact on earnings in the long term.

As investors look for growth and income in what has turned out to be a disappointing start for the Canadian stock market, the largest banks still offer the opportunity for rock-solid capital growth and attractive dividend yields.

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