



Why I'm Still Avoiding These 2 "Toxic" Canadian Financial Stocks

Description

Back in January, I'd recommended that investors avoid [two toxic stocks](#) that I personally wouldn't touch with a barge pole. At the time, the two stocks, **Canadian Western Bank** ([TSX:CWB](#)) and **IGM Financial Corp.** ([TSX:IGM](#)), were absurdly valued given the above-average risks that an investor would have taken on.

In just over two months' time, Canadian Western Bank and IGM Financial nosedived by ~18% and ~15%, respectively. Both stocks suffered far greater losses than that of the S&P 500 or TSX, which fell by ~5% and ~6%, respectively, over the same time span.

Although both stocks are substantially cheaper today, I still wouldn't touch them, nor would I advise any long-term investor initiate a position in either stock, no matter how much cheaper they get. I still think there's still a lot of pain ahead, not just over the near term, but over the long run, even if a market-wide crash doesn't end up happening.

Let's take a closer look at how both stocks are valued today and why I believe they're destined to fall further into the abyss.

Canadian Western Bank ([TSX:CWB](#))

At the time of my original sell recommendation, the stock was considerably more expensive than its Big Six peers. Moreover, the dividend yield was meagre (just shy of 3%) and was also dwarfed by its bigger brothers. And, most staggeringly, the business was much riskier with its overexposure to the Albertan market.

While I can see many buying Canadian Western Bank as a play on a rebounding Albertan economy, I fail to see why an investor would [risk their capital on a lower-yielding stock](#) with a questionable valuation, whose business has a severe lack of geographic diversification.

Personally, I'm not a fan of regional banks — more so if they're exposed to the troubled province of Alberta, whose borrowers are under considerable financial stress. Add the fact that the small yield gives little to no incentive for income investors to stick around for the long haul, and you have a stock

that's poised to be one of the biggest laggards in the Canadian banking scene.

Today, the stock trades at a more modest 12.76 times trailing earnings with a mediocre 3.07% dividend yield, which may seem decent until you have a look at **Canadian Imperial Bank of Commerce** ([TSX:CM](#))([NYSE:CM](#)) with its massive 4.71% yield, it's dirt-cheap 10.34 trailing P/E multiple, and its very promising expedition into the U.S. market.

IGM Financial

After the recent dip, IGM now has an attractive 6.05% dividend yield, which appears completely safe and is covered by free cash flow over the foreseeable future. Before you back up the truck though, you should know that by betting on IGM at these levels, you're betting that actively managed high-fee mutual funds will still enjoy a similar magnitude of demand in the future.

Given the popularity of passively managed investment instruments like ETFs and index funds, the improving financial literacy of the average Canadian aided by technology, and the potential for strict regulations on such mutual funds, I think the wiser move would be to bet against the sustainability of demand for such actively managed, high-fee mutual funds.

Although management has been investing in initiatives to realize sustainable long-term cost savings, I do not believe these improvements will be anything more than a drop in the bucket over the next decade, as the average Canadian investor begins to realize just how much of their retirement they're surrendering at the hands of these actively managed mutual funds.

IGM will either need to drastically lower its MERs to be more in line with industry standards and continue to hedge its mutual fund offerings with technologically advanced robo-advising services. Even if the company executes both initiatives to perfection, it looks like the company's going to suffer a substantial dent to its bottom-line numbers over the long haul, because the days of higher-margin high-MER mutual funds appear to be coming to an end.

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1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. TSX:CM (Canadian Imperial Bank of Commerce)
3. TSX:CWB (Canadian Western Bank)
4. TSX:IGM (IGM Financial Inc.)

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Date

2025/08/16

Date Created

2018/03/30

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