2 Reasons Bank Stocks Are a Great Bet in Late August

Description

The S&P/TSX Composite Index was up 91 points as of late morning trading on August 22. The index has bounced back after experiencing volatility due to international pressures. Slumping oil and gas prices and weakness in metals have also hurt the TSX, which is heavy in these sectors.

Canadian bank stocks have followed a similar trajectory to the prior year. Investors should know better than to expect historical performance to dictate present outcomes, but there is reason for optimism as bank earnings season is now upon us. Analysts have already projected a good round of earnings for banks. This would tie up what has been a very solid year for Canadian banks in what many were calling a potential down year with record profits reported in 2017.

What is behind this performance? Two factors that were feared by some investors as a potential drag have actually emerged as positives in the summer. Let's take a look.

Housing stabilization good news for banks

Canada housing has, for the most part, stabilized by the late summer. Home sales are still down marginally year over year, but July saw the first annual price increase since January. Policy makers have long warned that the housing situation in Canada had explosive potential, but so far new regulations seem to have done their job in effectively cooling the market.

Banks warned in the second quarter that mortgage growth would slow as the year has gone on. Indeed, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) retail banking head Neil McLaughlin said in a conference call today that there will be "modest slowing" as the year drags on. Stabilization in the housing market is ultimately good news for investors who were worried about the spread of a broader financial contagion.

Rising rates have been positive for earnings

When the Bank of Canada signaled its intention to embark on a rate-tightening path, there was understandable anxiety from the investing community. Lenders had benefited from nearly a decade of historically low interest rates, and this had seen mortgages, auto loans, and other credit products surge in this time period. The news was not all good for banks, though. Historically, low rates lead to thin margins and traditional deposit products have completely fallen out of favour with returns dipping below inflation.

Central banks have committed to tepid rate increases, which has gradually improved margins for banks. **Toronto-Dominion Bank**, which is expected to release its third-quarter results on August 30, posted double-digit growth in Canadian and U.S. Retail banking in Q2 on the back with higher margins playing a big role.

Royal Bank saw an 11% boost in net income in its recent third-quarter report. Improved net income in its Personal and Commercial Banking segment was powered by better deposit spreads that stemmed from higher interest rates.

Could another late rally be in the cards?

Bank stocks sparked a rally starting in August 2017 that extended into early 2018. The TSX has historically performed best in the latter months of the year, and Canadian banks appear poised to post a very solid earnings period in the third quarter. Investors should stick with these profit machines as we look ahead to the fall.

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Date
2025/07/05
Date Created
2018/08/22
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