A lingering Threat for Some of Canada's Best Dividend Stocks

Description

The past year has been one of the best for Canadian banking stocks. The nation's top lenders benefited from strengthening economy, a robust job market and rising interest rates.

Some of the nation's best lenders, including **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) and **Royal Bank of Canada** (TSX:RY)(NYSE:RY) and **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), delivered record profits and hiked their dividends.

This strength has been reflected in their share prices that surged between 10-15% in the past one year, outperforming the benchmark **S&P/TSX Composite Index** that gained just over 4% during that period.

But this party may not continue in the remaining part of 2018 if the U.S. and Canada failed to reach an agreement over free trade — a highly negative development for the Canadian economy that will likely force the Bank of Canada to reverse its interest rate hikes.

According to a recent report by JPMorgan Chase & Co., a U.S. withdrawal from the NAFTA deal would likely entail 25% tariffs on autos and dairy and force the Bank of Canada to slash interest rates by 50 basis points.

A report released by the Bank for International Settlements (BIS), a group composed of the world's central banks, found that scrapping NAFTA would cause a 2.2% dip in Canada's GDP.

An environment in which interest rates are rising bodes well for banks, which earn higher margins on their credit products, including credit cards, personal loans and mortgages. But a reversal of this growth scenario has the potential to damage the banking profitability and the overall economy. The possibility of this worst-case scenario is rising with each passing day.

U.S. Trade Representative Robert Lighthizer said on September 24 that the two sides were running out of time to reach an agreement on NAFTA and that a fair amount of distance remained between the U.S. and Canada.

While the U.S. and Mexico pursue a bilateral trade deal, Canadian Foreign Minister Chrystia Freeland left Washington last week without a resolution.

Bottom line

I expect some pullback in the share prices of Canadian banks, which have proven to be the best dividend stocks for income investors. If you're planning to take a position in Canada's lenders now, it's better to wait on the sidelines until the NAFTA threat is out of the way.

For those who already own banking stocks, any dip in their value will present another opportunity to add to your positions.

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3. NYSE:TD (The Toronto-Dominion Bank)
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