Canadian Banks: Top Trends to Watch

Description

Canadian banks have been beacons of strength in investors' portfolios, providing increasing dividends as well as strong capital appreciation for solid long-term wealth creation.

As the new year approaches, can investors continue to rely on the banks in order to drive their wealth?

Let's examine some of the trends we're seeing in Canadian banking results and try to ascertain what the future holds.

We will look at two banks in particular: **National Bank of Canada** (TSX:NA) and **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), as they are a reflection of broader trends that are being felt across the board.

Rising provisions for credit losses (PCL)

The banks are faced with an increasingly difficult loan environment, where the risks of loan defaults is higher, as the consumer is heavily indebted and fighting rising interest rates.

National Bank's PCL ratio was 24 basis points in 2018, and is expected to be as high as 30 basis points in 2019, thereby reflecting this changing environment.

CIBC's PCL ratio is also rising, and after a 2018 ratio of 23 basis points, will rise to over 30 basis points in 2020.

If you believe that rates will rise faster than the market is predicting, these estimates may prove to be too optimistic, so the downside risk to the banks remains.

Capital positions remain strong

National Bank's common equity tier 1 ratio (CET 1) is still a healthy 11.7%, and CIBC has a CET 1 ratio of 11.4%.

With banks aggressively buying back shares, this ratio can be expected to hold up for the Canadian banks as they did in the 2008 financial crisis. A focus on risk management in the form of less risk taking and increasing conservatism in the form of building up their balance sheet and capital structures will continue to pay off.

Dividend increases

Banks have kept the dividend increases coming, but next year it might be a little more difficult to do this, as risks are mounting and revenue growth is slowing.

National Bank is currently paying an annual dividend of $2.48 per share for a dividend yield of 4.29%.

The bank has increased its dividend twice in fiscal 2017, for a 5% total increase.

CIBC has also continued to increase its dividend in the last many years, and with a current dividend yield of 5.08%, this stock certainly pays investors to wait out the risks.

In summary

Canadian banks are facing many of the same risks that the economy in general is facing.

For the banks, it shows as slowing loan growth, PCL ratios rising, and mounting risks. But while Canadian bank stocks will probably see more downside in 2019, their dividend yields and solid capital management mean that they remain attractive on a long-term basis.

In the shorter term, investors should expect bank stocks to come under pressure, but if we look at history, we can see that Canadian banks have been extremely resilient in the face of incredible pressure.

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