3 Great Financials That Are Definitely NOT a Buy Today

Description

Once again, Bank of Canada pointed out the critically brittle nature of the Canadian consumer and the state of the housing market. This has led the bank to once again stand firm on rates instead of continuing on a raising cycle. The problem is that the over-indebted Canadian consumer is a consequence of low rates, and the brittle nature of the economy is a symptom of making credit too easy.

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So when investors think about investing in financial companies in Canada, they need to keep in mind the potential pitfalls they could face. For the last while, companies in the Canadian financial sector have been under pressure, not only from the general market malaise, but also because the world is well aware of the house of cards that exists in Canada. Whether these companies are large or small, almost all of them have been punished to a degree by the market.

The pressure on financial companies may tempt investors to look at the smaller-cap names like **Equitable Group Inc.** (TSX:EQB), **goeasy Ltd.** (TSX:GSY), and **Laurentian Bank of Canada** (TSX:LB). Each of these companies has a number of positive factors that make them tempting investments. For one thing, they're all fairly cheap. Equitable trades at a price to earnings (P/E) multiple of 6.8 times trailing earnings. Laurentian Bank has a low P/E of around 8.5. While goeasy is slightly higher, it still trades at a reasonable multiple of 17 given its recent growth.

The dividends are also all right for the price. Equitable, goeasy, and Laurentian Bank have yields of 1.75%, 2.1%, and a whopping 5.95% respectively. These companies are also growing their dividends as well, with Equitable announcing a 12% increase in the dividend over that declared in November 2017. goeasy increased its payout by 25% earlier in 2018, and Laurentian Bank raised its own by 1.5% in June.

With all these great attributes, why aren't they a screaming buy? Well, for starters, these companies earn their money on the backs of the Canadian consumer. Unlike the large Canadian banks, these companies are not diversified to a great degree, if at all, outside Canada. If there is a recession or even a contraction of spending, their customers may not be able to pay their bills. Debt is at an all-time high and interest rates are still close to all-time lows in spite of the few paltry dividend hikes.

As hard as it is to believe, bankruptcies are on the rise when the Bank of Canada's benchmark interest rate is still at a measly 1.75%. It's stunning to consider that when money is still basically free, people have borrowed funds to such a degree that they can't meet their obligations. At some point, something has to give.

More than likely the cause will be a recession. At the moment, people can still meet their debt obligations due to a decent job market. But what if those jobs disappear? What if (heaven forbid) real estate declines to a meaningful degree, reducing equity in homes? If that were to occur, there could be real pressure on the Canadian economy.

If there is a recession, there is a chance that these companies may feel some pain, leading to a reduction in their share prices. When everyone is dumping financials, it would be a good time to look at these stocks.

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If our economy wasn't leveraged to the extreme, then all of these companies would be a buy today. But in the same way a farmer, no matter how good, relies on rain for a bumper crop, financials are beholden to the strength of the economy and the spending power of the consumer. Given that our economy is on shaky, debt-laden ground, it might be a good idea to wait. These stocks are a buy, just not today.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. TSX:EQB (EQB)
2. TSX:GSY (goeasy Ltd.)
3. TSX:LB (Laurentian Bank of Canada)

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Author
krisknutson

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