Investor Beware: Have the Canadian Banks Turned Into Dud Investments?

Description

Canada's big banks have been under a considerable amount of macro pressure of late. With the flattened yield curve at risk of inversion at some point in 2020, investors were quick to ditch their bank stocks to the curb amid the recent October-December sell-off.

The Trump Slump, Powell Put, or whatever you want to call it, was ugly, and bank stocks suddenly fell to the cheapest levels they've been in recent memory. And while January was a relief for many, it'd only be prudent not to back up the truck on stocks that are up double-digit percentage points over the last month.

The Canadian banks that took the biggest hits to the chin during the Trump Slump, like **Bank of Montreal** (TSX:BMO)(NYSE:BMO), are now around halfway from peak levels. And although investors who were spooked in December may think it's a safe time to jump back into the banking waters, I think the odds of re-testing the lows are considerably higher than the odds of breaking past all-time highs.

Why? There are just too many headwinds in store over the next year to justify paying for shares that are only modestly discounted relative to historical averages.

BMO stock currently trades at a 10.1 forward P/E, a 1.5 P/B, and a 2.7 P/S, all of which are slightly lower than the bank stock's five-year historical average multiples of 12.5, 1.6, and 2.9, respectively. Based on traditional valuation metrics, BMO indeed looks like it's priced at a very modest discount.

The dividend yield, currently at 4.1%, is just 0.3% higher than it normally is, and although I'd usually recommend scooping up a bank stock any time it's fairly valued or better, there are many reasons to believe that, given the unfavourable macro environment, the bank stocks could be due for a prolonged period of consolidation in 2019.

Since the release of BMO's mediocre fourth-quarter results late last year, the bar has been slightly lowered by a handful of analysts, and although another "meh" quarter won't be enough to trigger another big plunge in shares, I believe investors would be better served waiting patiently on the sidelines for an opportunity to nab shares in the mid- to high $80 levels.

Foolish takeaway

I'd been pounding the table on the banks in December, as some banks like BMO, fell into bear market territory, but now that the best of bargains are in the rear-view mirror, I think investors are chasing them at these levels, and that's not a good idea if you're looking for risk-adjusted returns.

I wouldn't go as far as saying the banks are duds for the year, but I definitely think investors would be better off waiting for a better entry point, which could very well be in the cards over the coming months. If value and yield are what you're after, the utilities look like a better bargain today. Of course, this could change in the matter of a few weeks, especially if the market waters get rougher again!

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