Bank Stocks: Is the 10-Year Bull Run About to Come to an End?

Description

March 9, 2019 marked the tenth anniversary of the beginning of the record bull run on U.S. stocks that followed the global financial crisis of 2007-2008. The **Dow Jones Industrial Average** and the **S&P 500** have each climbed over 300%, while the tech-heavy **NASDAQ** has surged over 500% in the past decade.

The performance of the **S&P/TSX Composite Index** has been muted by comparison. In late 2018 I'd discussed some of the reasons for this. Canadian bank stocks have carried the load over the past decade, with the five largest financial institutions contributing nearly 50% of the gains on the index.

Canada's top banks are facing headwinds as we look ahead to the next decade. The batch of first-quarter earnings that were released in late February and early March were lukewarm. **Royal Bank of Canada** (TSX:RY)(NYSE:RY), Canada's largest financial institution, posted a solid quarter as net income rose 5% year-over-year to $3.17 billion. Net income in its Capital Markets segment did drop 13%, but this was primarily due to broader market volatility that negatively impacted results.

Toronto-Dominion Bank (TSX:TD)(NYSE:TD), Canada's second-largest bank, released a more mixed Q1 2019 report. Adjusted earnings were flat on a year-over-year basis with market volatility and lower client activity in its Wholesale segment, negatively impacting overall results. Still, TD Bank moved forward on a quarterly dividend increase to $0.74 per share, a 10% jump from the prior quarter.

Banks are facing difficult challenges that will threaten a decade of dominance on the TSX. Canadians are under increased financial pressure as household debt-to-income ratios have reached record levels. The debt-service ratio for households is expected to reach its highest point since 2008 this year. Historically, this has resulted in higher credit losses for Canada's biggest banks. Royal Bank and TD Bank have both ramped up its provision for credit losses in preparation.

Credit losses are not the only major risk to banks as we near the end of this decade. The developed world is facing the reality of a sustained low-growth environment as we head into 2020. Canadian GDP growth slipped to 1.8% in 2018 compared to 3% in the prior year, and gains in 2019 are expected to be tepid. **Bank of Montreal** recently cut its forecast to 1.3% GDP growth for the full year.

The Organization for Economic Co-operation and Development downgraded Canada’s 2019 growth forecast to 1.5%, and it expects investment to strengthen going forward. However, it still only projects 1.8% growth as part of a rebound in 2020, in line with dipping forecasts for global growth.

This does not mean that banks will encounter the kind of turbulence we saw during the financial crisis. However, investors should be cautious going forward and temper their expectations for what kind of growth Canadian bank stocks can provide into the next decade.

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