A U.S. Recession Would Hammer These 2 Bank Stocks

Description

Stocks were hammered late last week in the United States and Canada after the 10-year U.S. Treasury yield curve inverted for the first time since the financial crisis. Inversion suggests that there is at least a 25% of a recession occurring in the next 12-18 months. The U.S. economy has been a high performer in the developed world over the last two years, but recent events have inspired the U.S. Federal Reserve to pause their rate tightening path.

The U.S. economy has already slowed from the pace it set in 2018. Top U.S. banks warned in late 2018 that the benefits of tax reform had begun to wear off. The US Fed projected that growth would slip below 2% in 2020.

A recession is a different story, however, and some economists are warning investors not to overestimate the importance of the yield curve inversion. They point to a strong labour market that has underpinned consumption, which is the key driver of U.S. economic activity. Of course, this does not mean that investors should throw caution to the wind.

The U.S. economic expansion since June 2009 represents the longest since the expansion that spanned from 1991 to 2001. This was also the longest expansion in post-war history at 120 months. That means the current recovery is well on its way to becoming the longest in history. With headwinds on the horizon, investors need to prepare for the inevitable contraction.

Canada will always feel the ill-effect of a U.S. contraction. However, the two banks we will look at today have a particularly large U.S. footprint.

Toronto-Dominion Bank (TSX:TD)(NYSE:TD)

TD Bank boasts the largest US footprint of any other Canadian bank. This footprint was one of the main reasons I'd recommended TD Bank as a screaming buy after the passage of the *US Tax Cuts and Jobs Act* in late 2017. TD Bank soared to all-time highs in the fall of 2018 before suffering from a broader pullback in the global market.

TD's US sector fuelled earnings in 2018. In Q4 2018 the U.S. Retail segment saw adjusted net income rise 44% year-over-year to $1.14 billion. Shares had dropped 2.8% week-over-week as of close on March 26. TD Bank will still reap the benefits of US tax reform in 2019, but this impact will wane into the next decade. Any pullback in U.S. economic activity is bad news for TD.

Bank of Montreal (TSX:BMO)(NYSE:BMO)

BMO also boasts one of the largest U.S. footprints relative to its Canadian peers. U.S. Personal and Commercial Banking revenue rose to $3.87 billion in fiscal 2018 compared to $3.53 billion in the prior year. Adjusted net income surged to $1.11 billion over $823 million in 2017. Compare this to the modest gains in adjusted profit for the Canadian Personal and Commercial Banking segment; from $2.51 billion in 2017 to $2.55 billion in fiscal 2018.

BMO stock also surged to all-time highs in the late fall of 2018 before succumbing to market turbulence. Banks are already contending with anemic domestic growth. If a U.S. slowdown follows, or worse yet a recession, BMO stock will suffer.

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Date
2025/08/19
Date Created
2019/03/29
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