Are Canadian Banks Due for a Huge Relief Rally?

Description

The Canadian banks have been hard to own over the past several months. Not only are we as bank investors not used to triple-digit percentage moves in the red regularly, but we're not used to the downward moves at a time when almost everything else has been rallying big time. Indeed, it stinks to sit on the sidelines watching our bank stocks hover around in limbo over a handful of macro concerns that have become more apparent after the latest round of bank earnings results.

It doesn't help that short-sellers have come out of hiding with the intention of rubbing more salt into the wounds of the banks by saying things like "the banks will plummet by 40%" or something of the sort. The bank shorts have been wrong a countless number of times, and I believe this time will be no different. The Canadian banks are incredibly well capitalized and well managed such that a repeat of what happened in the U.S. during the Financial Crisis is likely out of the question, despite the comparisons made by many pundits.

While the stage could undoubtedly be set for further disappointment as we head into the second quarter, it's important to remember that the dire economic conditions and potential rate cuts may already be baked into shares of the banks and then some.

Scotiabank (TSX:BNS)(NYSE:BNS) stock has the additional concern over the recent slowdown in emerging markets, which has only been exacerbated by industry-wide concerns. With shares now within 6% of hitting multi-year lows, I think buying on the dip isn't as reckless as most pundits believe at this juncture.

Trouble with rocketing expenses drove Scotiabank's earnings into the red in Q1, and as you'd imagine, investors were quick to ditch the already ailing stock to the curb. While the 6% decline in diluted EPS seemed alarming, when compared to Scotiabank's peers, I thought the results were far more benign than many investors were led to believe.

Yes, the results stunk, but Scotiabank was in the midst of integrating a handful of acquisitions, and thus required some slack. The costs came at a bad time, and they made Scotiabank look a lot worse than it would have, but as the bank irons out the wrinkles from its prior acquisitions, I believe there's room for a significant upside correction once the bank stocks become great again.

The bar is really low. And I don't think it'll take much to pole-vault over it at these levels. The stock trades at 9.9 times next year's expected earnings, and with a dividend yield that's flirting with the 5% mark, I have no problem recommending shares at just $70 and change.

Foolish takeaway

Are the banks due for a relief rally? I'd look for the most-battered banks like Scotiabank to make an upside correction in the coming months. A bounce off 52-week lows is possible, so income-oriented investors may want to consider nibbling on the way down to get a higher yield basis.

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