



The Global Growth Slowdown Spells Trouble for Bank Stocks

Description

World markets [finished 2018 on a sour note](#), which inspired a policy U-turn from most central banks in the developed world. The United States Federal Reserve has indicated that a rate hike in 2019 is extremely unlikely. On April 24, the Bank of Canada maintained the benchmark rate of 1.75% and indicated that it had adopted a dovish outlook when it came to the prospect of rate hikes in the near term.

The BoC warned of slower-than-anticipated growth in the first half of 2019, even below its pessimistic target set in January. The global situation is no better. In early April the International Monetary Fund (IMF) warned that the prospects for the global economy were “precarious” in 2019. “Only two years ago, 75% of the global economy experienced an upswing,” IMF managing director Christine Lagarde said. “For this year, we expected 70% of the global economy experience a slowdown in growth.”

“The reality is that many economies are not resilient enough. High public debt and low interest rates have left limited room to act when the next downturn comes, which inevitably it will,” Lagarde added.

Canada possesses one of the highest debt-to-income ratios in the developed world. Its vulnerability to credit normalization is one of the reasons its financial sector has attracted the [interest of short sellers](#). Several top bank stocks were identified by infamous short-seller Steve Eisman in March and April. This is not the first time Canadian banks have attracted short attention, and more often than not, they have proven robust even in the face of severe headwinds.

Toronto-Dominion Bank ([TSX:TD](#))([NYSE:TD](#))

TD Bank is the second-largest financial institution in Canada. It boasts the largest U.S. footprint of any of its peers. The bank has benefited from the windfall after US tax reform, but this “sugar rush” has started to wear off in 2019. U.S. growth is projected to slow in 2019 and into the next decade.

In early March TD Bank senior economist Brian DePratto warned that “Things are probably going to get worse before they get better” in a client note. DePratto said that Canada was at risk of a “technical” recession, which is what happened to Canada in 2015 in the wake of the oil price collapse. These so-

called “solo” recessions may become more common in the future.

TD Bank and its peers are actively preparing and are beefing up provisions for credit losses, and investors should also be prepared. Valuations on the TSX have ballooned to kick off 2019, but economic realities may creep into the market sooner rather than later.

The next round of bank earnings is right around the corner. TD Bank is still trading at the high end of its 52-week range as of close on April 24. The stock had an RSI of 51 as of this writing, which puts it in neutral territory in this hot market. Improved market conditions should provide a boost for bank earnings in Q2 2019, but investors should actively prepare for turbulence as we head into the next decade.

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Date

2025/08/17

Date Created

2019/04/28

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