Investor Alert: Here’s What to Watch for When Canadian Banks Report This Week

Description

Investors have long held Canadian bank stocks in their retirement savings accounts — and have been very handsomely rewarded for this.

Banks have seen exceptional long-term performance, giving shareholders ample capital gains as well as dividend income, but in the months and years ahead, we have to consider that things are changing.

Debt levels are high and the housing market remains at risk, and these are dangerous things for in a consumer-led economy.

So this week brings with it quarterly reports out of the Canadian banks.

Here’s what to watch for.

Provisions for loan losses (PCL)

Canadians remain very heavily indebted.

In the fourth quarter of 2018, Canadians owed on average $1.79 for every dollar of disposable income.

I know this is something that has been talked about for a long time now yet the market has kept roaring ahead. But has the time of reckoning finally come?

If we look and listen to Canadian banks, we can see early signs that it has.

Over at **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), PCL increased more than 20% in the first quarter of fiscal 2019 compared to the previous quarter, and while on the consumer side there is some seasonality due to the holiday shopping season, these numbers do suggest that the heavily indebted consumer is a big risk for the banks’ earnings.

Canadian Imperial Bank of Commerce’s (TSX:CM)(NYSE:CM) PCL ratio is also rising, and after a 2018 ratio of 23 basis points, will rise to over 30 basis points in 2020.

One thing is for sure, PCL is trending higher and the risk to the estimates is that they are not high enough.

Mortgage loan portfolio

Mortgage growth has slowed to 17-year lows as more stringent mortgage-qualifying standards have taken their toll on the Canadian housing market, which has topped out in 2018, leaving Canadian banks with a big chunk of their business that they will look to replace.

While CIBC is still one of the banks with more exposure to consumer lending with its greater than average exposure to Canada and to personal/mortgage lending, CIBC has been ramping up its expansion efforts in wealth management with much success.

With the acquisition of U.S. Commercial Banking and Wealth Management PrivateBancorp, which represents more than 10% of the bank’s earnings, CIBC has effectively moved toward geographic and business diversification.

Final thoughts

With the banks starting to report next week, we will be reminded of the long-term case to own them in our retirement accounts, including their strength and resiliency, and their ability to return capital to shareholders in the form of dividends.

Keeping the risks in mind, own TD Bank for its 4% dividend yield and its leading position in Canadian and U.S. banking, and own CIBC stock for its 5.06% dividend yield, its attractive valuation, and its moves toward diversification.

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