Banking on International Markets? Consider Buying Scotiabank (TSX:BNS) Stock

Description

The Canadian banking industry is facing tough times–and it's never been a better time to invest in Canadian banks. That statement might sound paradoxical, but when you understand one of the crucial things about Canadian banks, it makes perfect sense.

Canadian banks don't just do business in Canada. In fact, many, are highly international in scope. **TD Bank** is famous for its U.S. Retail business, which makes up 30% of its total earnings and is growing larger every year. TD isn't the only Canadian bank with loads of international exposure either. From **RBC** to **CIBC**, there are plenty of Canadian banks making a splash on the world stage.

That said, not all Canadian banks are equal in their amount of foreign investment. Like RBC, some have only minimal operations in foreign countries, while others are almost defined by their international and/or U.S. presence.

If you're looking for a bank with a major international footprint to offset potential losses due to credit issues in Canada, **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) may be your best bet. To understand why that's the case, you first need to understand the problems facing Canada's banking sector.

Problems facing the Canadian banking sector

I wouldn't be the first person to tell you that Canadian banks are in a tough place. Hedge fund managers, like Neuberger Berman's Steve Eisman are currently betting against the Big Six in a major way. Their theory? Credit quality is deteriorating, and banks haven't adequately prepared themselves for the consequences.

This theory has a lot to recommend it. Canadian household debt is currently sitting at $2 trillion, which, when combined with the fact that Canadian houses are among the least affordable in the world, doesn't make for a smooth economic ride. Throw tanking house prices in several key markets into the mix and you've got a recipe for disaster.

The factors outlined above constitute the main thesis for shorting Canadian banks. However, banks with international exposure may be much less vulnerable to them.

Scotiabank's PCL

"Provisions for credit losses" is a banking term used to describe funds that banks set aside for defaults. In its most recent quarter, Scotiabank's total PCL was at $873 million, up from $534 million in the same quarter a year before, thereby indicating that Scotiabank believes that it's facing a much greater risk of defaults than it did previously. However, unlike many banks, it has a powerful weapon to counter any such losses.

International diversification

Scotiabank's ace in the hole is its international diversification. Well known as the "most international Canadian bank," it has sizeable operations in South America, Asia and Europe. In its most recent quarter, Scotiabank's Canadian bank earned $1 billion, while its international banks earned $700 billion, which means that Scotiabank's international operations are almost as large as its Canadian ones.

The reason this matters is that it provides Scotiabank with a measure of geographic diversification to protect it from risks at home. Canadian credit and housing market problems aren't going away any time soon–Scotiabank's own rising PCL is a testimony to that–so if you buy a Canadian bank, it pays to buy one that's more international. Scotiabank, with 40% of its operations outside of Canada, fits the bill perfectly.

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