Is This Canadian Bank at Risk?

Description

There has been a lot of negative publicity lately regarding the Canadian banking system. Our housing market is inflated. Debt levels in Canada have reached nose-bleed levels. The government seems determined to support the debt binge, keeping interest rates at such a low level that, to many, it seems ridiculous to avoid taking on debt.

With the cost of debt at all-time lows, you have to assume that asset prices must be at or near all-time highs. Inflation is here, just not in the way in which central banks tend to measure the statistic. The banks have done well with these low rates, lending to ever-hungrier consumers. But these historically low rates have potentially put our financial system at risk. Therefore, should you buy any Canadian banks at these levels?

The answer is pretty simple. If you are not able to ride out a major downturn in banks, you should probably stay away. There is likely to be a major downturn in the financial system in the next several years, so unless you are able to buy more shares at lower prices or at least hold on to your existing shares, you should not even consider owning bank shares.

When you are looking at the numbers, it is hard to imagine why you would not want to own shares of any Canadian bank. Take **Equitable Group** (TSX:EQB) for example. The stock has consistently been going up over the past several years. If you had bought the stock after its hard fall in the spring of 2017, you would now be sitting on a gain of almost 100%. Not bad for a bank stock that makes its money through lending and insurance.

The numbers look quite good as well in their recent reports. Equitable's deposits were up 23% year over year, meaning consumers trusted the bank enough to give it their money. And for all the talk of a housing downturn, it still manages to lend out a significant amount of that money to Canadians. In the first quarter of 2019, net interest income increased by 4% — not a bad number considering much of that money came from debt-laden Canadians. Total revenue increased double digits, up 13% year over year.

Furthermore, the bank's diluted earnings per share were up 16% to hit a record of $2.72 a share. These results have allowed the company to return capital to shareholders in the form of dividends as well. Although the dividend looks pretty small at 1.79%, its dividend growth has been quite impressive.

In the first quarter, Equitable raised its dividend by 15% as compared to its May 2018 dividend.

Hold your nose and buy for the long term or stay away

Equitable has done a fantastic job of turning deposits into earnings. Its lending practices have been pretty solid, leading to some great earnings growth. But the problem with the Canadian consumer remains. Equitable is operating primarily in Canada, and the economy is debt ridden.

For the long term, you have two choices. Buy in right away and stay the course for the long term or keep away. Personally, I am going to wait and see what happens. For all the great results the bank has produced, the fact remains that it is operating in an economy that is already drowning in leverage. If there is a downturn, it is most certainly at risk and will be hit.

But if you are able to stay the course and hold this bank through thick and thin, its growing dividend and good operating history should be enough for you to ride out a potential downturn.

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