How Can Canadian Banking Investors Avoid Unseen Risks?

Description

Canadian bank stocks are attractive investments, combining defensiveness, good value for money, and rich and stable dividends. For many reasons, a bank stock is a good starting point for a new investor on the TSX. However, a number of market stressors could impact your favourite stocks, with the potential to make mincemeat of even a carefully managed dividend portfolio.

Silent stressors could be the most dangerous

While some macroeconomic stressors are fairly obvious and could relate to almost any stock on the TSX, such as a deterioration in the health of the Canadian economy, other risks are specific to banking. These include a loss of market share from a banker not held in your portfolio, a sudden buyout from a rival lender (unlikely, given that there are so few large banks in Canada), and a pullback in retail credit.

Other risks include a meltdown in the domestic and American housing markets, not unlike the housing bubble of 10 years ago, and a prolonged downturn in the banking sector itself. Of these, the three risks of most concern to a long-range dividend investor would be a widespread market correction, an implosion in the housing market, and a shift in market share among the Big Five.

How can a banking investor reduce risk?

There are three simple ways to skirt around the threat of a market downturn: reduce risk, know what you're holding, and stay invested. The most obvious way to reduce risk quickly is to sell any stocks that have matured whose outlooks would be unfavourable given a correction. Knowing what's in a portfolio is also key, especially if you manage it yourself. And holding stocks through a recession takes nerve but also the knowledge that the market will eventually recover.

In terms risks specific to banking, it comes down to which threat seems the most relevant to your portfolio. For instance, if the housing market is of the biggest concern to you, holding **Scotiabank** may seem too risky for your appetite. If a U.S.-led market deterioration keeps you up at night, you may want to reduce exposure to markets south of the border by paring back your **TD Bank** shares.

In this light, **CIBC** (TSX:CM)(NYSE:CM) looks like a good all-rounder at the moment, and has been trading with an attractive P/E ratio for some time. Paying a rich dividend yield of 5.65%, CIBC has a sturdy track record of earnings growth coupled with generous dividend hikes. With 11 million customers focused on the Canadian market, CIBC is the stock to go for if you're bullish on the Canadian economy.

The bottom line

Investors seeking to enter a long-term position in CIBC have a good opportunity to do so at its current valuation. Given its domestic focus, the banker is more insulated than some of its peers from market disruption coming from the U.S., though no Big Five stock would be immune to a widespread market downturn. That said, CIBC is relatively safe and pays a substantial and dependable dividend — just right for a low-risk portfolio of top TSX stocks.

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