Are Canadian Banks Skating on Thin Ice?

Description

The Fed's slashing of interest rates doesn't bode well for American banks. It doesn't bode well for banks on this side of the border either, as it's likely that the Bank of Canada is likely to follow the Fed in lockstep moving forward — or we could be looking at a much stronger loonie.

In any case, Canada's banks have been looking quite solid over the past few weeks amidst the growth-to-value rotation. The Canadian banks haven't looked this good in quite some time.

While the outlook remains bleak, with many analysts still maintaining their "hold" ratings on most Canadian banks with the expectation of rising expenses and more provisions as the banks transition into the next credit cycle.

In prior pieces, I noted that the banks looked like solid bets in spite of all the pessimism and their weak outlooks. The bar was set low, the valuations were too good to pass on, and the dividends were that much more appealing with yields that were slightly higher than that of historical averages.

Most important, I thought there was more upside to be had by buying before the release of a rally-inspiring quarter that would spark a series of analyst upgrades.

When it comes to the Steady Eddie banks that have been paying dividends for many decades, it made sense from a risk/reward standpoint to go against the grain.

Now that banks are becoming sexy again, with **CIBC** (TSX:CM)(NYSE:CM) bouncing over 10% after I encouraged investors to back up the truck before the company lifted the curtain on its better-than-feared results, the natural question remains: is this rally the real deal or is it just a head-fake before the next round of capitulation?

I believe the rally is the real deal. While a chunk of the gains posted in recent weeks could be partially surrendered, I do believe that there's ample value to be had for long-term investors who seek a margin of safety alongside a slightly higher yield.

That said, investors shouldn't expect rabbits to be pulled out of hats when it comes to growth after credit normalization. Given that expectations are still low; however, I do see the most beaten-up of bank stocks like CIBC correcting by another 10-15% to the upside.

Investors are beginning to realize how robust the banks are, and as the book-talking shorts run from the media limelight, I do expect investor confidence to return before the banks get back on the right track.

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