Why This Analyst Is Wrong About Canadian Banking Stocks

Description

Nigel D’Souza is not a big fan of Canadian banking stocks today.

D’Souza, who is an analyst for Veritas Investment Research, recently told host Catherine Murray on *BNN Bloomberg* he’s bearish on the Canadian banking sector. He sees various concerns weighing on bank shares, including a risk of an imminent recession, increasing loan losses impacting these companies’ bottom lines, and contraction in price-to-earnings ratios.

D’Souza summarized his view: “Keep in mind management teams at the banks themselves have said they expect credit losses to continue to normalize. So if you think credit losses will continue to go up, you want to buy bank stocks in the future, not right now.”

Respectfully, I disagree entirely with D’Souza’s view on Canadian banking stocks. I’ve been buying recently for my portfolio and would continue to do so at today’s prices if I didn’t already have healthy positions already established. Here’s why I think his bearish call is wrong today.

The skinny on banks

The argument has been the same for years now. Canadian banks are too exposed to overvalued real estate and an overly indebted Canadian consumer. When the next recession hits and it impacts the real estate market, we’ll start to see massive loan losses.

There’s no doubt a recession will impact Canadian banks. I know that. You know that. Everyone knows that, including the smart folks who are in charge of these banks. They’ve had years to prepare for the top of the economic cycle.

We also must remember Canadian banks are diverse businesses with significant exposure to other parts of the world. Take **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), which continues to be my favourite bank stock today. Scotiabank earns approximately one-third of its total net income from Latin America from places like Chile, Colombia, Peru, Panama, and Mexico. Those foreign operations immediately protect investors from any issues with the Canadian economy.

Scotiabank is also incredibly diversified here in Canada. It has operations from coast to coast, which is a good reminder to investors that there are essentially several “mini-economies” here in Canada. Ontario and Quebec, for example, are booming, while oil-dependent regions out west are barely posting any economic growth. Scotiabank — and its peers — are protected by banking in every province, as well as operating in different parts of the financial services sector, including insurance, wealth management, and capital markets.

Nice valuations

I follow a simple mantra for investing in the Canadian banking sector. If valuations are attractive, then it’s time to selectively start buying.

Despite a decent run-up in the share price over the last month, Scotiabank shares are still very cheap. Analysts think the company will earn $7.15 per share in 2019, with the bottom line increasing to $7.56 per share in 2020. That gives shares a forward price-to-earnings ratio of under 10 times, which is very cheap.

Scotiabank shares are also cheap on a price-to-book value perspective, checking in a stock price of 1.4 times book value. Some of its peers trade for as much as two times book value. I’d argue 1.5 times book value is a reasonable short-term target.

The bottom line

Nigel D’Souza might be right over the short term, and Canadian bank shares could decline, which would represent the perfect long-term buying opportunity. After all, Canadian banks have slowly made investors rich for over a century now. It’s been a silly move to bet against them.

The dirty, little secret of Bay Street analysts is they really don’t know where a stock will go over the short term. Nobody does. I’m much more confident in my ability to predict long-term moves. And I’ve bet a lot of money on Canadian bank stocks being a good place to invest over a few decades. It really is that simple.

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