



Is Carnage Coming to Canadian Bank Stocks in 2020?

Description

With the banks' fiscal fourth-quarter results mostly behind us now, we're left with the reality of having to reconcile these results with our investment strategy/holdings.

Should we continue to hold bank stocks? Should we lighten up on our holdings?

[A big motivation for holding bank stocks is for their generous and growing dividends.](#) Unless the whole economic system is in big trouble, this can be expected to remain the case for many banks who have grown their reach and their businesses over the years. If we take a long-term view of this, we can view any weakness in bank stocks as a buying opportunity.

That said, there's no denying that there are problems that the banks are facing that will impact bank stocks in 2020.

Loan loss provisions keep rising

This intuitively makes sense. We know that Canadians are heavily indebted, and we know that this can't go on forever despite record low interest rates.

According to Statistics Canada, Canadians' debt to income ratio rose to 170% in 2019, a level that has kept rising and that places households at risk.

This, in turn, places banks at risk. Credit ratios will deteriorate and loan loss provisions will rise. We have already seen this in recent quarters, and this should serve as a warning signal to investors.

Canadian Imperial Bank of Commerce ([TSX:CM](#))([NYSE:CM](#)) reported a sharp rise in provisions for credit losses (PCL) in its latest quarter. The provision was \$402 million, up 38% compared to the prior quarter and up 52% compared to the prior year.

We can expect this rising trend to continue into 2020. So with this, the bank reported fourth-quarter and year-end 2019 results that disappointed the market pretty significantly.

EPS was \$2.84 compared to expectations of \$3.06, a more than 7% miss. A more than 5% drop in CIBC stock price followed on the day of the report.

In addition to this, slowing loan growth remains evident in CIBC's results. Management has stated that the slowdown in mortgage and real estate loans has been more dramatic than expected and that we should expect the environment to remain challenging.

Capital markets division weakens

This also intuitively makes sense. Capital markets have taken a hit this year with lower IPO activity and general market uneasiness and volatility.

The Canadian oil and gas sector has weighed on the results across the board at Canadian banks. Provisions for losses have also hit this segment's results largely as a result of the Canadian oil and gas sector's woes.

Over at **Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)), the wholesale banking segment reported a sharp drop in net income, coming in at \$160 million compared to \$286 million last year. This was a function of sharply higher provisions for losses and lower equity underwriting and advisory fees.

TD Bank is the Canadian bank with an unrivalled leadership position and history of success. Its success has translated very nicely to shareholders, with a five-year compound annual growth rate (CAGR) in dividends is 9.5%, a dividend policy of annual increases, and a stock price that's risen more than 40% in the last five years.

But it too has come under pressure as a result of the challenging environment. [Fourth-quarter results also came in well below expectations](#), with PCLs rising dramatically and weakness in the Canadian business showing up pretty much across the board.

Foolish bottom line

Canadian banks are at a crossroads today. Low interest rates are catching up to them as they continue to drive down net interest margins, loan growth slows and credit losses accelerate.

It's the perfect storm — signifying that these banks will face hard times in 2020.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:CM (Canadian Imperial Bank of Commerce)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:CM (Canadian Imperial Bank of Commerce)
4. TSX:TD (The Toronto-Dominion Bank)

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