Why Now Is the Time to Get Greedy With the Canadian Banks

Description

It’s easy to be bearish on the Canadian banks after they stumbled amid tightening credit conditions in 2019, but that’s precisely why you should consider checking in on them. Many of the Big Six banks have been treading water over the last two years, and in some instances, the bearishness and pessimism have become overblown beyond proportion.

The Canadian banks are still premier financial institutions. Yet, some of the banks are priced as though provisions, thinning net interest margins (NIMs), rising expenses, and sluggish growth will never come to an end. The credit cycle is just that — a cycle. And when the dust has a chance to settle (when credit has the opportunity to normalize completely), we’ll begin to the next phase, and it could see a rise in some of the overly depressed bank stocks that have been ditched by those impatient investors who are investing for the next year and not the next decade.

It’s pretty useless worrying about what others on Bay Street are already concerned with. You’re also doing yourself no favours by following the herd out of names that most others have already thrown in the towel on. To be a true contrarian, you’ve got to go against the grain and skate towards where the puck will be headed next, not where it’s at currently.

Most analysts on the Street have muted expectations for earnings growth for the Canadian banks in the new year.

Darko Mihelic of RBC Dominion Securities stated in a note that he “expect[s] 2020 to be better, but not easy,” forecasting EPS growth of just 4.7% for fiscal 2020. Not bad, but nothing to write home about for those seeking a rebound after two years of meagre returns from the bank stocks.

In any case, provisions should be more controlled in 2020, as the banks, even the poorly prepared ones, have had the opportunity to free up liquidity to deal with soured loans.

With such a low bar to pass, I would lock in the slightly higher-than-average dividend yields on some of the more battered bank stocks here before the analysts flip their “holds” to “buys” when more evidence suggests that we’ve entered normalized conditions.

While the downturn could continue through most, if not all of 2020, it does make sense to do some buying today, especially if you've yet to top up your TFSA with another $6,000. It'll hurt to buy a battered bank, but that's what it should feel like when you go against the grain as a contrarian.

Consider **Scotiabank** (TSX:BNS)(NYSE:BNS), a Canadian bank that's fallen into a rut well before the Canadian bank short-sellers came under the limelight of the financial media to talk up their books (or talk down their shorts). The stock fell into bear market territory (a 20% peak-to-trough decline) last year, but has since recovered a bit of ground, now down 15% from late-2017 all-time highs.

While the stock isn't out of the woods, I find the valuation and the dividend (currently yielding 5%) compelling. The stock trades at just 10.1 times next year's expected earnings, a real bargain given the increasing appetite for high-quality yield.

More recently, Scotiabank announced items that will be material for its first-quarter results, most notably a $175 million gain on the sale of its operations in Thailand. As Scotiabank frees up more liquidity while getting expense management under control, I see the stock as a name that could fly higher when we slowly but steadily move into a more favourable banking environment.

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joefrenette