A Recession Is Unlikely in 2020

Description

It has been over a decade since the U.S. housing bubble imploded and triggered the Great Recession, which was the most significant global economic downturn since the Great Depression almost a century ago.

The current bull market, which started in March 2009, is now the longest in history. It has seen many stock markets around the globe hit record highs, including the **S&P 500**, which gained around 274% over that period, and the **S&P/TSX Composite Index**, which rose by a more modest 85%.

Fears of a looming recession continue to weigh on stocks and financial markets. Growing economic and geopolitical uncertainty, because of ongoing trade tensions between the U.S. and China as well as conflict in the Middle East, are fanning those fears. While an economic downturn appears long overdue, there are signs that the global economy will continue to grow in 2020.

Improving outlook

World manufacturing activity, after a slew of poor data, appears to have stabilized, and many economies, notably among emerging markets, have returned to growth. The International Monetary Fund (IMF) is predicting that global gross domestic production (GDP) will expand by 3.4% and then by 3.6% in 2021. That bodes well for Canada, with the economy forecast to grow by 1.8% in 2020 and 2021.

A stronger domestic economy will particularly boost growth for the banks after a lacklustre 2019, where the Big Five failed to outperform the broader market.

Stronger consumption, particularly household spending, and improved business confidence will drive firmer growth in Canada, which will be especially beneficial for the banks. There is a direct correlation between higher economic activity and greater demand for credit, while a stronger economy also typically means that the volume of impaired and past-due loans will subside.

That allows banks to reduce lending loss provisions, freeing up capital that can then be deployed for loans and investments, which bolsters earnings. Analysts anticipate that the housing market will improve during 2020, with it expected that sales activity and prices will surge. That also bodes well for the Big Six banks because a significant proportion of their earnings are generated by mortgages.

One bank that will benefit considerably from an improved economy in 2020 is **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM). It is the most domestically focused of the Big Five, even after making a series of U.S. acquisitions over the last four years.

Canadian residential mortgages make up 55% of all loans outstanding as of the end of the fourth quarter 2019. Real estate and construction loans also make up a large portion of Canadian Imperial's loan book, further highlighting that a firmer economy and stronger housing market will benefit the bank.

The key beneficiaries will be Canadian Imperial's personal and small business banking as well as commercial banking and wealth management divisions. Those businesses experienced improved growth during the fourth quarter 2019, because of a firmer economy, which saw loan and deposit volumes expand at a steady clip.

The bank finished 2019 with a quality loan portfolio, as evidenced by its gross impaired loans ratio of 0.47%, indicating that it would take a significant economic decline to have a material impact on Canadian Imperial's loan portfolio and balance sheet. It is also well capitalized, finishing the fourth quarter 2019 with a common equity tier one capital ratio of 11.6%.

Foolish takeaway

Canadian Imperial's weak performance over 2019 saw it fall into disfavour with the market, which is why it has only risen by a paltry 1% over the last year. This has, however, left it attractively valued, trading at a share price which is 1.4 times its book value and just under nine times its projected earnings.

That indicates that the bank is too cheap to ignore, making now the time to buy. While investors wait for Canadian Imperial to unlock value and for its stock to rally, they will be rewarded by its sustainable dividend yielding a tasty 5%.

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