Could the Canadian Banks Plunge Further Amid Interest Rates Cuts?

Description

Things just went from bad to worse for Canada's banks, which are already busy combating the adverse effects that come with a national credit downturn. The U.S. Fed announced an emergency interest rate cut to prepare from the economic damage that's to come from the coronavirus (COVID-19). Despite the greater inflationary pressures on this side of the border, the Bank of Canada (BoC) is expected to follow in the footsteps of other central banks with a similar rate cut of their own.

Lower rates are more bad news for the Canadian banks, which are already doomed to suffer from flat growth for a year that's likely to see less loan growth at even lower margins. At this juncture, it seems as though the short-sellers that set their cross-hairs on Canada's banks over ill-preparation for a transition into the next credit cycle are right on the money. But given Canadian banks have taken on considerable damage of the past week amid the coronavirus correction, is such bad news already baked into Canadian bank stocks? Or are there hidden risks that could send them into even more of a tailspin?

It's hard to remember when there were this many risks on the table for the big banks. And while the Big Six could take a spill over the near to intermediate term as their net interest margins (NIMs) stand to take a hit over falling interest rates, longer-term income investors have to be enticed by the value proposition at this juncture. The hunt for yield has become tougher, but here you have many Canadian banks with yields that are close to the highest they've been in recent memory.

CIBC (TSX:CM)(NYSE:CM) now sports a nearly 6% dividend yield, which is previously unheard of for a Big Five bank stock. Macro headwinds have taken a toll on CIBC, with surging provisions, hard-to-control expenses, slowed loan growth, and thinning NIMs. CIBC has evidently had a tougher time dealing with the recent credit downturn that many of its peers, and, as a result, the stock has fallen on its face.

At the time of writing, shares trade at 8.5 times next year's expected earnings and 1.3 times book, both of which are considerably lower than the stock's five-year historical average multiples of 10.2 and 1.7, respectively. On the surface, CIBC looks like a bargain for the ages, and while the dividend is likely to continue growing past the 6% mark, likely through a combination of dividend hikes and further pressure on its share, investors may want to tread carefully with a name that most consider being the riskiest Big Six player to own in a sustained downturn.

You’re getting a cheaper stock with a more bountiful dividend, but that comes at the cost of potentially amplified downside risk in a worst-case scenario. As such, investors may want to look to bank stocks that have demonstrated more resilience through the current credit downturn if they’re thinking about biting on the bank’s big yields.

We could be on the road to 0% interest rates, and if that’s the case, you’re going to want a bank that can hold its own in a crisis — not one that crumbled like a paper bag during the last one.

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