Top Canadian Stocks To Avoid on the BOC Interest Rate Cut

Description

The central banks are once again dipping into their tool box. Australia began the wave of interest rate cuts on Monday and others soon followed. In North America, the U.S. cut rates by 50 basis points on Tuesday, while the Bank of Canada also cut rates by 50 basis points.

This marked the first interest rate cut in Canada since 2015. Earlier this week, I brought to your attention a couple of stocks that stood to benefit from a cut in rates. Unfortunately, whereas a rate cut is a tailwind for some industries, it's a headwind for others.

The two most impacted are banks and insurers. When interest rates are cut, the spread between what financials can earn on interest from its credit products compared to the interest it pays out narrows. In effect, this leads to lower profitability. With that in mind, here are two financial stocks investors may want to avoid in a period of low rates.

Laurentian Bank of Canada

A regional bank based primarily in Quebec, **Laurentian Bank of Canada** (TSX:LB) is more vulnerable to a lower rate environment than its peers. As the big banks are more diversified, they are better equipped to deal with lower rates.

Laurentian Bank is also the only bank in North America with a unionized workforce. The company endured more than a year of labour unrest before finally agreeing to a new collective agreement in early 2019.

This headwind is unique to Laurentian Bank and as such is an additional risk not present at other banks, resulting in additional costs.

Furthermore, the company has been undergoing a significant strategic shift; it aims to become a leading digital bank. The costs associated have been high, and profit has eroded as a result.

The outlook doesn't look any better. Over the next five years, Laurentian is expected to eke out average earnings growth of 0.54% annually, which is lower than any of the Big Five banks.

The company is trading at cheap valuations, but it's cheap for a reason. Until the company completes its transition and returns to meaningful growth, there are better options in the banking industry — namely, any of Canada's Big Banks that are also cheap today.

Fairfax Financial

When it comes to insurers, it was a tough choice. However, I chose **Fairfax Financial** (TSX:FFH) for a number of reasons. For those *not* in the know, Fairfax is run by Prem Watsa, who is largely regarded as Canada's premier value investor. In fact, he is referred as "Canada's Warren Buffett."

Unfortunately, this comparison seems to have lost its relevance. Fairfax Financial has made several bad investments in recent years, and its share price has suffered as a result.

Over the past five years, Fairfax has lost approximately 14% of its value. In comparison, the **S&P Composite Index** is up by 9.59% over the same period.

Fairfax serves as a holding company, yet its primary business is insurance — similar to that of Buffett's Berkshire Hathaway.

A cut to rates is often associated with lower premiums, the key source of income for Fairfax. Given that the company has struggled with its recent investments and is prone to taking big risks, a decline in premiums could further pressure the stock.

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1. Bank Stocks
2. Dividend Stocks
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TICKERS GLOBAL

1. TSX:FFH (Fairfax Financial Holdings Limited)
2. TSX:LB (Laurentian Bank of Canada)

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Date
2025/08/18
Date Created
2020/03/06
Author
mlitalien