Market Crash: A Top Contrarian Stock for Canadian Investors to Buy Today

Description

The latest market crash has seen the big five Canadian banks pummelled. Canada's largest lender, Royal Bank of Canada, has plunged by 15% over the last month, while the most international institution, **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) has lost 19%.

Despite the poor short-term outlook, however, this has created a contrarian opportunity to acquire Scotiabank at an attractive price.

Long-term outlook

Scotiabank is currently trading at a mere nine times its forecast annual earnings and 1.3 times book value. While the bank could pull back further as fears of a global recession stoked by the coronavirus climb, this shouldn't deter you from buying.

Scotiabank pulled through the last major global economic crisis, the Great Recession of 2008, in fine shape and has delivered considerable value since then.

In fact, as 2008 Scotiabank has delivered a total return of 125%, if dividends were reinvested it would equate to a compound annual grow rate (CAGR) of 7%. Regardless of the softer outlook for Canada's banks, Scotiabank reported a solid fiscal first quarter 2020.

Those results included net income expanding by 4% year over year, a 5% increase in adjusted earnings per share and a return on equity of 14.2% that was 0.7% higher than a year earlier.

The better-than-expected results were driven by improved performances from Scotiabank's global banking and markets, wealth management and Canadian banking operations.

In fact, global banking and markets reported a stunning 35% year-over-year increase in adjusted net income on stronger loans, deposits and revenue. The solid performance of those divisions offset the weak results reported by Scotiabank's international business that saw net income fall by 4% compared to a year earlier.

Strong balance sheet

Notably, Scotiabank is well capitalized. It finished the first quarter with a common equity tier one capital ratio of 11.4%, which was 0.3% greater than a year earlier. The bank has a high-quality loan portfolio, as is evidenced by its low gross impaired loans ratio of 0.77% — a notable 0.13% lower year over year.

That along with a 2% decrease in the value of allowances for credit losses, indicates a material improvement in credit quality.

Those attributes indicate that Scotiabank is well equipped to weather the current storm engulfing financial markets and the global economy. It would take a massive decline in credit quality and sharp rise in loan defaults to have any significant impact on the quality of Scotiabank's loan portfolio and hence balance sheet.

Scotiabank has also employed a variety of mechanisms to mitigate the impact of a sharp decline in credit quality on its balance sheet. These include having around half of its Canadian residential mortgages insured and a conservative loan to value ratio for those who are uninsured.

Short-term risks

The degree of risk associated with Canada's big banks appears overblown. While there are short-term headwinds ahead, their long-term prospects remain strong. That's because they operate in a heavily regulated oligopolistic industry with steep barriers to entry that protects them from competition.

This highlights their importance to the domestic economy, indicating that demand for their basic products and services will remain firm even amid an economic slump.

Among the greatest threats to Scotiabank's earnings over the short term are Bank of Canada's latest 0.5% rate cut, which will compress margins, and a weaker economy. Scotiabank also has considerable exposure to the Latin America economies of Mexico, Colombia, Chile and Peru.

Those nations, because of their reliance upon the extraction and exports of commodities, are exceptionally vulnerable to a global economic downturn. If the economic fallout from the coronavirus is as severe as some pundits are predicting, it could lead to a sharp decline in earnings from Scotiabank's Latin American business.

Looking ahead

The short-term outlook for stocks remains poor, particularly as we don't know how coronavirus will impact the economy. This, however, shouldn't prevent you from buying Scotiabank during the market crash.

It is attractively valued and possesses robust long-term growth prospects. Scotiabank continues to reward investors with a sustainable dividend that now yields a very tasty 6%.

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