Canadian Bank Stocks Crash: Should You Buy This Dip?

Description

There's no sugarcoating it anymore: Canadian bank stocks are crashing. Not just correcting, not flirting with bear market territory, but crashing — violently so.

If you're like many Canadians, you probably woke up in horror yesterday morning to see not only the **TSX Index** crashing over 10% in a day, but many blue-chip holdings in your portfolio down in the deep double digits. If you're a stranger to volatility, these are terrifying times and enough to make anyone want to hit the panic button.

The Canadian bank stocks are among the bluest of blue chips out there. And with them, you're getting a solid dividend and relative stability — until Mr. Market pulled the rug from underneath investors on Monday, with **Bank of Montreal** and **Toronto-Dominion Bank** leading the downward charge, shedding 13.3% and 12.3% amid the rout in oil prices.

At this juncture, it appears as though stocks are uninvestable. The markets continue tanking in the deep double digits nearly every day amidst mounting uncertainties. Nobody knows what's going to happen with the coronavirus (COVID-19), the fate of the now severely battered energy sector or how banks will deal with rapidly falling interest rates.

Are the banks still investable amid plunging interest rates?

We're in a rock bottom interest rate environment. That's bad news for retirees, savers, and the financials.

As central banks around the world race to 0% interest rates (or negative rates), things could get rough, especially for the banks, which can better profit in a higher interest rate environment.

Low interest rates aside, the banks are already in a world of pain amid the Canadian credit downturn. They're suffering from fewer loans at lower margins, drawing what could be the end of the glory days of profitability. That said, the banks have been making moves to position themselves for the continued credit downturn better.

However, the Bank of Canada made the job of the banks that much harder as it followed in the footsteps of the Fed with an interest rate cut that could precede many more. More rate cuts mean even thinner net interest margins (NIMs) for the banks, which has many Canadians throwing in the towel on their former market darling bank stocks.

The industry environment went from bad to worse, especially for the banks that made loans to junior energy firms with an elevated risk of insolvency like **Canadian Western Bank**, which nosedived over 16% on Monday.

Short-sellers that actively targeted the Canadian banks last year are surely laughing their way to the bank amid the latest slide. Although it seems all hope is lost in a time when the magnitude of uncertainty couldn't be greater, I'm still an advocate of buying the banks on the way down.

More yield for less

We're in the midst of a biological crisis. Such crises don't happen very often, but when they do, stocks decline in price very rapidly, and their yields tend to grow accordingly.

When's the last time a premium bank stock like Bank of Montreal sported a 6% yield at around eight times forward earnings? The Financial Crisis of 2007-08. Yields of bank stocks soared as their shares tanked. And while BMO sported north of a 10% yield near the bottom, the window of opportunity to lock-in such a ridiculously high yield was limited as its shares bounced back.

So, if you panic, you'll miss out on a chance to get more (safe) yield for less.

Yes, the Canadian banking scene is disgusting right now — and it could become even more disgusting over the coming months should rates continue falling to 0%, further pressuring ROEs in the process. But as someone wise once said, "this too shall pass," and the same could be said for the banks as they navigate through these rougher waters.

By buying bank stocks here, you'll undoubtedly take short-term pain, but you'll lock-in a larger yield, and if you intend to hang in there for years at a time, you shouldn't let any near-term moves influence your long-term investment strategy.

The banks are best-in-breed. They've risen out of crises before, and they'll do it again. Those who bought gradually on the way down came out the other end very rich. And I think this time is no different.

Now that many bank stocks have lost over 30% of their value, it's time to start doing some buying.

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Author
joefrenette