TFSA Investors: Market Crash Makes Canadian Bank Stocks Attractive

Description

Investors who use their Tax-Free Saving Accounts (TFSAs) to build wealth for their retirement have a unique opportunity to gradually buy Canada's bank stocks, which have been hammered in the current market crash.

The average dividend yield of the top five bank stocks in Canada is touching 6% that was unthinkable a few weeks ago. But before you decide to buy these stocks for your TFSA portfolio to benefit from their high yield, we need to understand what's at stake for these lenders in this current crisis, which has been triggered by the coronavirus outbreak.

From a Canadian perspective, the biggest risk for these lenders is coming from the sudden plunge in energy prices. Investors are fearing that if this slump continues, many lenders will face rising bad debts as the nation's many energy companies could face bankruptcies.

On Monday, the price of West Texas intermediate oil collapsed about 25% in its worst one-day decline in about three decades after Saudi Arabia and Russia failed to agree on an output cut arrangement.

Oil sector exposure

In contrast to general perception, Canadian banks are actually not that much exposed to the energy sector. According to a **National Bank Financial's** recent note, the Big Six banks' exposure to the North American oil and gas sector has fallen to about 2% of their overall loans from more than 5% prior to 2014. In dollar terms, total exposure comes to about $60-billion.

"We estimate that stressed loss rates in oil and gas portfolios would reduce [bank] sector earnings per share by 2% to 6% ," National Bank Financial analyst Gabriel Dechaine said, using the prior oil downturn as a template.

Beyond the energy risk, Canadian banking profits are also going to take a hit from the falling interest rates and the real possibility of a recession in the next two to three months as the coronavirus pandemic plays havoc with the economy.

While these risks are clearly reflected in the current valuations, long-term TFSA investors should carefully plan their move and look for the right opportunities to buy these solid lenders that pay regularly increasing dividends.

Among the top six banks in Canada, my two favourite names are **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) and **Royal Bank of Canada** (TSX:RY)(NYSE:RY). Both lenders have the lowest exposure to the oil and gas sector, with TD at 1.3% and RBC 1.2% of the total loan book.

After falling 30% in the past one month, TD stock now trades close to $53 a share, with a dividend yield surging to 5.45%. RBC, after falling 27% during the same period, now trades at $57 a share, and yields more than 5%.

According to Dechaine, the current valuations imply an ugly environment for the Big Six, including 2020 profits falling 14% and dividend increases put on hold.

“To state the obvious, this figure is much more than what we estimate in terms of the EPS impact of a repeat of the 2015-16 oil and gas downturn,” he said. After that downturn ended in early 2016, bank stocks rallied an average of more than 40% within 12 months, and dividends continued to increase.

Bottom line

TFSA investors, whose aim is to earn higher dividend yield, should be ready to deploy their cash in this market downturn and buy their favourite dividend stocks that have become very attractive. Top Canadian banks are certainly among them.

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