Canadian Bank Stocks Are Too Cheap to Ignore

Description

Over the past few days, a sense of optimism has returned to the markets. The price of oil is off lows thanks to hopes of a production cut, while COVID-19 mitigation efforts appear to be working. Over the past week, the S&P/TSX Composite Index has gained 4.25%. Considering this, now might be a good time to take a closer look at Canadian bank stocks.

Over the same five-day period, the S&P/TSX Financial Index has only gained 2.04%. Financials continue to trail the Index, and once again this presents an opportunity for investors.

As European banks are cutting dividends, analysts are estimating that U.S. peers will follow suit. But Canada's Big Six banking CEOs have publicly announced their intention to maintain dividends.

Although a dividend raise is likely off the table for the foreseeable future, Canadian bank stocks are well capitalized. Should they escape this crisis without a dividend cut, they will have reaffirmed their status as some of the best income stocks on the planet.

The largest Canadian bank stock

Canada's largest bank, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) is among the best to own in a bear market. Need proof? One need only to look at the company's performance during the current market crash.

Over the past three months, RBC has lost only 16.76% of its value. This is best among Canadian bank stocks. Likewise, it is outperforming the Financials Index (-22.91%) and the S&P/TSX Composite Index (20.54%).

Likewise, Royal Bank is now yielding 5.26%, which is near record highs. Historically, buying the bank when it yields above 5% has proven to be a wise decision.

There is no question that Royal Bank of Canada is cheap. Trading at only 9.5 times earnings, it hasn't been this cheap since the Financial Crisis. Picking up the largest Canadian bank stock at today's prices is truly a once-in-a-decade opportunity.

The worst-performing Big Six bank

Let's turn our attention to the worst-performing bank stock — **Bank of Montreal** (TSX:BMO)(NYSE:BMO). Over the past three months, Bank of Montreal has lost 29.67% of its value. It is significantly underperforming the Index and industry peers.

This underperformance, however, is a little perplexing. Despite downward revisions across the industry, Bank of Montreal has the highest expected earnings-growth rate among Canadian bank stocks.

The problem likely lies in the fact that at about 2.5% of loans outstanding, BMO has the highest exposure to Canada's oil patch. Since the price of oil is trading at prices not seen in almost 20 years, the expectation is for higher provision for loan losses in the industry.

What is not reflected, however, is that BMO is less exposed when total commitments are taken into consideration. In fact, it is among the least exposed in the sectors when loans and lending commitments are both taken into consideration.

Lending commitments include items such as untapped lines of credits. When the going gets tough, it is likely oil and gas companies will tap out their line of credits. We are already starting to see this trend emerge. Since this trend is likely to accelerate, BMO may actually be one of the least exposed to the industry.

Bank of Montreal is trading at only 8.1 times earnings at a 40% discount to historical averages. There is no cheaper Canadian bank stock.

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