Market Crash Alert: Bank of Montreal (TSX:BMO) Plunges 25%

Description

Bank of Montreal (TSX:BMO)(NYSE:BMO) stock was crushed during the market crash. At one point, the stock was down nearly 40%. Even after a brief recovery, the stock is still 25% away from its February highs.

Countless investors are flocking to the stock. Dividend investors are attracted to the 5.7% yield. Value investors are lured in because BMO stock trades at its cheapest valuation in years. Even growth investors are getting involved, hoping market pain will clear the way for Bank of Montreal to take market share from struggling competitors.

One thing is clear: this stock hasn't gone on sale in more than a decade. Is now the time to jump in?

Understand the market crash

The market crash of 2020 has been a roller coaster. That's because it has not one, but two forces driving the downturn.

The first impact is one you're very familiar with: the coronavirus. Shutdowns and quarantines have hit businesses hard, both big and small. Multi-billion-dollar airlines like **Air Canada** will need direct government intervention to survive. Meanwhile, your favourite local restaurant may have already folded.

We haven't even gotten to the effects on everyday Canadians. Last month's job report was the worst in recorded history. More than three million Canadians are now out of work or have seen their hours reduced. Household debt has been on the rise for years, so the upcoming recession could be a doozy.

At the minimum, expect reduced consumer spending for many months to come due to the coronavirus. That'll add even more stress to businesses across the country.

The second impact has largely been overshadowed: the oil market crash. At the start of the year, oil was priced at US$60 per barrel. Today, prices are approaching US$20 per barrel. What happened?

For years, major oil-producing countries like Saudi Arabia have been ceding market share to Canadian oil sands projects and U.S. shale facilities. To prop up prices, the country proposed a supply cut for OPEC, the global oil cartel. Russia refused, so Saudi Arabia retaliated, *slashing* prices to punish dissent.

Oil investors are hoping the pricing war is a temporary phenomenon. But it's possible that Saudi Arabia will keep prices low until higher-cost producers permanently exit the market. As we'll see, this could have devastating effects for banks like BMO.

Should you buy BMO stock?

Think of banks as leveraged bets on the economy. If the economy rises, banks can take advantage in an outsized way. If the economy tanks, banks are first up on the chopping block. That's why BMO shares dropped so sharply from the coronavirus threat. But it's the oil threat that could be the biggest long-term challenge.

Roughly 10% of Canada's GDP stems directly from the energy sector. That's a $170 billion contribution to the economy. Significantly more businesses and individuals are indirectly benefited. Even the loonie responds rapidly to changes in commodity prices. If there's trouble brewing for energy producers, the effects will be felt throughout Canada for a long time.

Unfortunately, Canada has some of the highest-cost oil production in the world. Massive oil sands operations, for example, don't break even unless prices surpass US$40 per barrel. That means oil would need to rise by 90% for several large Canadian producers to simply break even.

The fallout across North America has already begun. In recent days, **Whiting Petroleum** became the first oil company to file for bankruptcy, citing a "severe downturn" in demand and pricing.

According to *Reuters*, "The industry is estimated to owe more than $200 billion to lenders through loans backed by oil and gas reserves. As revenue has plummeted and assets have declined in value, some companies are saying they may be unable to repay." Sources told the company that large banks are preparing to seize assets directly to stem the losses in their loan books.

This bring us back to Bank of Montreal, which has direct exposure to every aspect of the Canadian economy, including the oil and gas industry. In 2018, the bank expanded its fossil fuel loan book by more than $3 billion in a single transaction. It now maintains a higher-than-average vulnerability to the future of Canada's energy industry.

This is simply not the place to be putting long-term capital to work, especially since the market crash has provided dozens of other lucrative opportunities. BMO stock will need to fall significantly further for shares to become interesting.

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rvanzo