



Recession Risk: Avoid These 2 Financial Stocks for Now

Description

I am a big fan of owning the Big Five Canadian banks as long-term holds. In spite of the challenges they will face regarding an economic recession, a possible housing crisis, and the second major collapse in oil prices in less than a decade, these stocks are solid. Unfortunately, I would not extend that same leeway to every financial institution in Canada.

Financial risks

I would not, for example, buy **goeasy** ([TSX:GSY](#)) or **Equitable Bank** (TSXEQB) today. These financial institutions are [far more exposed](#) to the weak Canadian consumer than the large Canadian banks. The Big Five Canadian banks have much more diversified businesses than these smaller financial institutions.

Growth rates have been huge

Both of these companies have had huge growth rates over the past several years. goeasy, for example, saw its loan portfolio increase by 33% year over year, leading to a 20% increase in revenue. Adjusted annual earnings per share increased by 45%.

All of these impressive numbers allowed the company to increase its dividend by 45% as well. This gives investors a dividend yield of about 5% at the current share price.

Equitable also had substantial results in 2019. Its annual adjusted earnings per share were up 22% year over year — a record number for the company. Equitable's deposits were up by 13% from year-end 2018. The company raised its annual dividend by 23%, resulting in a 2.44% yield at the current market price.

Then why be concerned?

The positive results were very encouraging when they were reported back in February. They indicated that both companies reported serious growth. That growth was reflected in their double-digit dividend

growth.

The problem with the company lies in both banks' connection to the Canadian consumer. Canadian consumers were cash strapped before this crisis hit. In fact, one of the reasons that Canadian consumers went to these financial institutions was because of their rather poor financial situations.

When borrowers were refused at the big banks, they would often go to these second-tier banks. This fact is especially true in the case of easyfinancial, which lends relatively small amounts at rates greater than 29.99%. If a serious economic recession takes hold, these borrowers could potentially default in great numbers, leaving easyfinancial in a situation.

The same holds true with Equitable, although Equitable appears to be the stronger of the two companies. Its loan book is of a more traditional nature, focusing on mortgages offered at a similar rate to the Big Five Canadian banks. Its issue lies more in its singular focus on the Canadian housing market. It simply does not have the scale that the larger banks possess.

The bottom line

While it appears that both of these banks possess excellent growth rates, I would not yet step into either of these names. Certainly, their prices have come down significantly over the past month. Nevertheless, they are very tied to a Canadian economy that is sitting on a razor's edge at the moment.

On the other side of this multifaceted crisis, it might be [a good idea](#) to buy shares of these companies. The time to do this is when the economy improves. There is no way to know how devastating the combined impacts of the coronavirus, government spending, and work shutdowns will be on the already weak Canadian economy. Proceed with caution.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. TSX:EQB (EQB)
2. TSX:GSY (goeasy Ltd.)

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