Can Canadian Bank Stocks Make You Rich?

Description

The Canadian bank stocks are stuck in a massive rut. Macro headwinds continue mounting, and with more soured loans coming as a result of the insidious coronavirus, it certainly seems like the Big Six banks have become more of a speculation than a blue-chip investment these days.

Shares of the major Canadian banks haven't participated as much in the latest relief rally. This continued underperformance has many wondering if the banks could be in for another move lower, given everything falls back on the banks when the economy heads south.

Impaired loans are coming, lower loan growth at lower margins and the potential for negative interest rates (and oil prices) leave the bank stocks as highly uncertain plays in these unprecedented times. With the massive negative momentum and highly uncertain outlook, the banks look to be dangerously risky, but if you've got the stomach for volatility, I see the broader basket of bank stocks as a must-buy for younger investors who can stomach the high risks for a shot at outsized returns once the banking scene inevitably turns around.

Bank dividends will be put to the test

With the Canadian credit downturn in full swing, oil's latest rout, and coronavirus-induced bankruptcies of many small- and medium-sized businesses imminent, the perfect storm has undoubtedly hit the banks. The seemingly unsurmountable headwinds have some bears thinking that a bank dividend cut may finally be on the horizon.

A Big Six Canadian bank cutting its dividend was unfathomable last year. You would have been laughed out of the room if you brought it up when the Canadian banks were navigating through the credit downturn!

As the pandemic drags on and the severity of the coronavirus recession worsens, such a big banking dividend cut doesn't seem quite as ridiculous anymore, even though the banks remain well-capitalized and the dividends, well-covered.

Add the potential for negative oil prices and interest rates into the equation, and it certainly seems that unprecedented times warrant unprecedented actions such as dividend cuts.

That said, it's going to take more than a worst-case scenario for the big banks, especially higher-quality ones like **Royal Bank of Canada** (TSX:RY)(NYSE:RY), to take their dividends to the chopping block. As such, investors looking to go against the grain with the Canadian banks have a chance to lock-in an outsized yield by buying here and continuing to hang on as they navigate through the coronavirus typhoon.

From a long-term perspective, you can get rich from such a name that allows you to have your cake (big capital gains in a rebound) and eat it too (a huge yield).

Stick with higher-quality (not higher-yield) Canadian bank stocks

I'd stick with the highest-quality bank stocks like Royal Bank, rather than trying to reach for yield with riskier plays like **CIBC,** which currently sports a 7.4%-yielding dividend.

Royal Bank has a terrific capital markets' business, which can hold its own better than retail banking during times of severe economic hardship. Royal Bank also has a stellar book of loans and has a structural advantage to many of its Big Six peers, making it arguably one of the best-positioned banks to make it through the coronavirus typhoon without taking on excessive amounts of damage.

While the discount on Royal Bank shares may not be as steep as some of the other bargains out there (shares off just 24% from highs), I am a huge fan of the risk/reward trade-off given the wide range of possibilities that could result from this pandemic.

If the pandemic drags on for longer than expected, Royal will have dampened downside relative to the pack, and once the tides turn on the banking scene, Royal Bank could come roaring back, enriching those that bought the name on the dip.

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1. Bank Stocks
2. Coronavirus
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