Investors: Are Canadian Banks Still Worthy Investments in the Age of Coronavirus?

Description

The coronavirus virus has decimated many sectors of Canada's economy, and all of the pressure looks to be falling right back on the shoulders of the Canadian banks.

Just a dozen years ago, the Canadian banks were in a world of pain as they found themselves at ground zero of the Financial Crisis, a time when the future of the financial system was up in the air. Many investors were increasingly pessimistic on the Canadian banks as they plunged into the abyss.

Those who threw in the towel after Canadian bank stocks imploded missed out on an epic rally and a chance to lock-in massive dividend yields.

For Canadian bank investors, it feels like the 2007-08 Financial Crisis all over again, but there are critical differences this time around.

The bear case for Canadian banks is ridiculously gloomy

In the face of profound COVID-19-related uncertainties, some of the bears out there think that the financial system will come under an unprecedented and unfathomable amount of stress. Such stress could cause Canadian bank stocks to implode further while their dividends head for the chopping block.

The Canadian credit downturn and the disruptive impact of COVID-19 have made some question the solvency of the Canadian financial system. The capital adequacy of the Canadian banks is far better than it was before the Great Recession, but if a depression is looming, the banks may be at risk of a magnitude of downside that could dwarf the implosion that occurred in the lead-up to the Great Recession.

Canadian banks: A sound investment or speculation in the age of coronavirus?

It's hard to gauge just how much more damage the Canadian banks will take.

The magnitude of damage ultimately depends on the coronavirus and the severity of the recession it will leave behind. In a way, the Canadian banks, among the bluest of blue-chips, now may seem more like some sort of speculation than an actual investment.

If this pandemic drags on and employment doesn't recover promptly, many mortgage deferrals could turn into defaults. Such a horrific scenario could spark a Canadian housing meltdown, causing a domestic-mortgage-heavy bank like **CIBC** to lead the downward charge.

Similarly, if this pandemic lasts longer than most believe, oil demand could wane much further, and a potential return into negative oil price territory could trigger a slew of bankruptcies in the Canadian oil patch.

Such a scenario would cause **Bank of Montreal** (TSX:BMO)(NYSE:BMO), which has above-average exposure to oil and gas (O&G) loans, to fall much further.

In the face of such considerable uncertainty, it's tough to justify going against the grain with any of the Canadian banks at this juncture. None of the Canadian banks is immune from further downside if this pandemic worsens, and pressures could find themselves increasing from all sides.

On the flip side, an effective vaccine could send the Canadian bank stocks collectively skyrocketing back towards all-time highs. In such a scenario, the hardest-hit banks like BMO would lead the upward charge, and the opportunity to lock-in the sky-high bank yields will vanish at what will seem like an instant.

Foolish takeaway

If you're optimistic that a COVID-19 vaccine can be produced relatively quickly and that we're not going to fall into a depression that could rival the one suffered in the 1930s, it makes a tonne of sense to buy shares of the Canadian banks right here.

In the era of coronavirus, the risks involved with bank investments are much higher, but so too are the potential rewards. As such, Canadian bank stocks still offer a favourable long-term risk/reward trade-off given the wide range of possibilities for long-term investors willing to bear the risks.

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