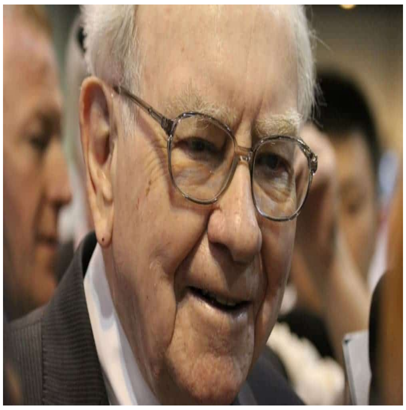

Warren Buffett Reduces Exposure to the Banking Industry: Should You Exit Canadian Bank Stocks?

Description

According to **Berkshire Hathaway's** (NYSE:BRK.A)(NYSE:BRK.B) latest SEC filings, investment mogul Warren Buffett has reduced exposure to two large banking companies. The Oracle of Omaha cut his stake in **Goldman Sachs** by a whopping 84%, and the decline for **JP Morgan** stood at 3% in the March quarter.

At the end of Q1, Berkshire Hathaway had 1.92 million shares of Goldman Sachs, down from 12 million in the December quarter. The Warren Buffett-owned company now has 57.7 million shares of JP Morgan. Does this reduced exposure to banking stocks mean anything? Should Canadian investors follow suit and exit banking stocks right now?

Warren Buffett reduced airlines exposure last month

Earlier this month, we saw Warren Buffett exit airline stocks. This dragged shares of **Air Canada** lower by 28% in the current month. Can we now expect shares of Canada's top banking giants to experience a correction in the near term?

The Warren Buffett indicator calculates the total market cap of the stock market as a percentage of the country's GDP. If this multiple is over 100%, it indicates the stock market is overvalued, and vice versa. Currently, the Canadian stock market to GDP ratio is close to 107%, and this figure south of the border stands at 134%.

We can see that the U.S. equity markets are significantly overvalued, but companies on the TSX are also vulnerable. It's quite possible that Warren Buffett expects the market to move lower in the next few months. Berkshire Hathaway, in fact, increased its cash balance to US$137 billion in Q1, up from US$128 billion at the end of 2019.

A look at the performance of top five Canadian banks

Canadian banking giants have huge exposure to the energy sector — an industry that has been decimated due to falling oil prices. Further, increasing unemployment rates might also result in mortgage defaults, making banks a vulnerable buy in the current market.

Royal Bank of Canada is Canada's largest company. RBC stock price stands at $82.64, which is 25% below the 52-week high. The recent weakness in RY's stock price has meant its dividend yield stands at 5.2%.

Toronto-Dominion Bank has a market cap of $99.3 billion. TD stock closed trading on the TSX last week at a price of $54.9, which is almost 30% below the 52-week high. This decline in TD's stock price has meant its forward yield is a tasty 5.8%. TD Bank stock continues to trade at an attractive valuation multiple and remains a North American giant, despite recent weakness.

Bank of Nova Scotia has also underperformed the broader markets in 2020. BNS stock price closed trading at $49.97 last week, which is 35% below its 52-week high, BNS stock has a forward yield of 7.2%, making it an attractive bet for income and contrarian investors.

Bank of Montreal has a market cap of $40 billion. BMO stock is currently trading at $62.37, which is 41% below its 52-week high. The decline in BMO's stock price has meant investors can enjoy a dividend yield of 6.8%.

Canadian Imperial Bank of Commerce has a market cap of $35.3 billion. CIBC stock is currently trading at $79.27, which is 32% below its 52-week high. The decline in CIBC's stock price makes its forward yield of 7.4% extremely attractive.

Canadian bank stocks might move higher after the recent pullback

While Warren Buffett has reduced his exposure to the banking sector, he maintained stakes in financial companies such as **Wells Fargo**, **American Express**, **Bank of New York Mellon**, and **Bank of America**.

The COVID-19 pandemic is likely to be a near-term headwind. This means unemployment rates will move lower once lockdowns end. Oil prices will also rebound, as demand continues to move higher in the second half of 2020.

If you invest a $10,000 each in Canadian's top five banks, you will generate $3,250 in annual dividends. The pullback in Canadian bank stocks provides investors with an opportunity to benefit from capital appreciation as well when broader markets rebound.

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