
Will Canadian Banks Push the TSX Index Lower?

### Description

The relief rally in the **TSX Index** has already lasted longer than expected and faces the moment of truth this week. Top six Canadian banks are set to release their second-quarter earnings this week. While financial stocks form one-third of the TSX Index, their quarterly numbers will notably move broader markets in the short term.



## Canadian banks and the TSX Index

Canadian bank stocks at large have fallen more than 25% so far this year, while the TSX Index has lost approximately 15%.

The Canadian economy entered a recession this month amid the pandemic. Importantly, the huge amount of uncertainty and fear will likely continue to weigh on business activities, even as major economies re-open.

The country's biggest bank, **Royal Bank of Canada**, will release its quarterly earnings on May 27. **Bank of Nova Scotia** will report its numbers on May 26.

## Highest-ever provisions

The banks' bottom lines will mostly take major hits in their upcoming releases. The period includes the quarter that ended on April 30, which was dominated by lockdowns and subdued business activities.

Importantly, the overall situation for Canadian banks looks grim, as several negative factors have stemmed at the same time. Rising unemployment, weakness in the second-most important — the energy sector, and rock-bottom interest rates will weigh on Canadian banks during the quarter.

The banks' earnings could notably fall with unprecedented provisions for the quarter. Banks generally set aside specific amounts for loans that may go bad in the future, which is called as a provision. Many analysts estimate Canadian banks to report around 30-40% earnings decline for the quarter ended

April 30.

What’s notable here is, we might see wide-ranging amounts of provisions from these banks, as no one knows how the pandemic will affect them, say, six months from now. Apart from the earnings impact, provisions will also highlight how pessimistic the banks really are about the future. These uncertainties could weigh on bank stocks this week.

The second-biggest bank, **Toronto-Dominion Bank**, will release its earnings on May 28. It has already informed of a $1.1 billion provision for its U.S. retail division. TD Bank has one of the most significant presence in the U.S. compared to any other peer banks in the country. Such a big provision only for the U.S. segment stresses on how deep the dent on its earnings could be.

## TSX Index: What investors should do?

So, what should investors do amid all these uncertainties? I think a few weak quarters should not alter the theses of long-term investors. If Canadian banks report weaker-than-expected earnings, the stocks could see further weakness.

It could be a worthwhile opportunity for investors, particularly those who did not act in the earlier crash in March. However, the downside should be limited, as TSX bank stocks are already trading at a notable discount from the valuation standpoint.



Big banks in the country such as Bank of Nova Scotia and Royal Bank pay stable dividends investors can count on. They have been there for years and have seen multiple recessions, emerging even stronger after each one.

Bank of Nova Scotia has paid dividends for the last 187 consecutive years. It offers a dividend yield of 7%, the highest among peer top banks. Even if earnings decline significantly, I don’t see that hampering their dividends. However, if the pandemic and the economic weakness lasts longer than expected, it might weigh on their future dividend growth.

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