WARNING: Are Bank Stocks Discounted or Dangerous?

Description

Canada's Big Six banks received significant praise following the 2007-2008 financial crisis. Experts lauded their conservative style and stiff regulatory requirements. Banks are being tested again by the COVID-19 pandemic. This financial crisis threatens to be even worse than the Great Recession. Canadian bank stocks were hit hard in the spring. Should investors look to buy low, or is the worst still ahead of Canada's banks?

Canadian banks: How risky are they?

In the spring of 2019, Steven Eisman of *The Big Short* fame called out some of Canada's top financial institutions. He said that Canada's banks were ill-equipped to pull through the end of a credit cycle. No one at the time could have predicted the financial chaos that has been wrought by the COVID-19 pandemic. Regardless, Eisman has won big off his position a year after his bold call.

Banks moved to mitigate risk in the second quarter. **Royal Bank** (TSX:RY)(NYSE:RY) and its peers saw provisions for credit losses soar in the year-over-year period. Meanwhile, many analysts and experts are still nervous about the financial situation for Canadians going forward. The Big Six banks revealed that they allowed deferred payments on more than $180 billion of residential mortgages and real estate-secured loan balances in the three months prior to April 30.

Canada came into this crisis with its citizens possessing troubling debt levels. The financial situation has worsened for millions of Canadians. This could jeopardize the credit book for Canada's top banks going forward.

These stocks still look attractive value wise

Despite the apparent macro risks, bank stocks boast attractive technicals right now. Back in June, I'd discussed why banks stocks like **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) looked like a great purchase. Canada's investment environment for banks should be friendly in the foreseeable future. The Bank of Canada has suggested that it will pursue a benchmark rate of near zero for two years or more.

Shares of CIBC have dropped 10% in 2020 as of close on July 16. The stock has been largely flat month over month. CIBC stock last had a favourable price-to-earnings (P/E) ratio of 10 and a price-to-book (P/B) value of 1.1. The stock last paid out a quarterly dividend of $1.46 per share. This represents a strong 6.2% yield.

Royal Bank is Canada's largest bank by market cap. This bank stock has increased 15.8% over the past three months. Royal Bank stock last had a solid P/E ratio of 12 and a P/B value of 1.7. It offers a quarterly dividend of $1.08 per share, which represents a 4.5% yield.

Should you snatch up bank stocks today?

Bank stocks have bounced back in part from the sharp correction in the early spring. However, CIBC and others still have a hill to climb to reach their annual highs. Canada has a long way to go before it achieves anything that resembles normalcy on the economic front. Because of the risks, I'm gunning for the high-reward bank stock in this environment. CIBC stock boasts nice value and a mouth-watering dividend.

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