Undervaluation: You Won't Believe How Cheap This Bank Stock Has Become!

Description

Growth stocks that have been riding high on pandemic tailwinds have led this latest relief rally. Going into year-end, this could change on a dime, as investors eagerly await the arrival of an effective COVID-19 vaccine. The COVID-hit areas of the market (think banks, energy, restaurants, travel, retail, and real estate) could start to catch up. As such, investors may find it wise to trim profits off their recent winners and rotate into cheap bank stocks to gradually increase their COVID-19 beta and maximize upside potential on the advent of a vaccine.

Bank stocks: Buying what others are selling

One place that reeks of value right now is the Canadian banking scene. The Big Six banks are all historically cheap, but for investors willing to go the extra mile for even better value, the regional banks may be the place to go right now. They're unfathomably cheap here, and although they're facing seemingly unsurmountable headwinds, one has to think of the upside potential, as such headwinds gradually begin to fade. Should we be in for the advent of a vaccine, such absurdly cheap bank stocks, which have taken a brunt of the damage amid the coronavirus crisis, could blast-off over a concise time frame in a correction to the upside.

Until a vaccine lands, though, it's hard to know if such dirt-cheap regional bank stocks are actually undervalued. This pandemic could continue dragging on for years in a bear-case scenario, and such a situation would be devastating to a bank's loan book, especially if they're overexposed to the weakest parts of the Canadian economy.

A regional Canadian bank stock that offers a deeper discount to the Big Five

Canadian Western Bank (TSX:CWB) is an absurdly cheap regional bank that currently trades at 0.77 times book value. The bank has more than its fair share of exposure to western Canada, which includes the ailing energy-heavy province of Alberta, which has been feeling the full force of the

COVID-19 impact. Although oil and gas (O&G) loans now contribute a smaller chunk of the overall pie, Albertan loans still account for approximately a third of Canadian Western Bank's book.

With a massive 1.72 beta, Canadian Western Bank will continue to be extremely volatile for the duration of this pandemic. Although the bank stock trades at a lofty discount to book value, there's no telling just how steep the discount could become as macro pressures continue weighing on the bank's capital ratio.

The regional Canadian Western Bank may not be the best capitalized of the pack. Still, the pressures and unfavourable loan mix are likely already well-baked into the share price at current levels. Canadian Western Bank has its third-quarter results on tap for August 28. Expectations are pretty muted, calling for a 27% year-over-year decline in EPS numbers, as increased provisions for credit losses and meagre net interest margins continue to weigh.

John Aiken, an analyst at Barclays, sees Canadian Western Bank achieving solid loan growth and steady margins. Uncertainties surrounding the energy scene remain a real risk, however.

Foolish takeaway

With a 4.9% dividend yield, Canadian Western Bank is a compelling deep-value option for income-savvy investors who seek amplified upside in a return to normalcy. If you crave a deep discount to book, it may make sense to initiate a position here, and more after the bank pulls the curtain on its Q3 results next week.

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