Why Now May Be a Good Time to Sell Bank Stocks

Description

It's been a mixed week for Canadian banks, though overall positive. **BMO** rose 3.7% on its earnings beat, while **Scotiabank** (TSX:BNS)(NYSE:BNS) tumbled 1.1% having missed expectations. Other **TSX** bank stocks have fared well, seeing average gains of around 7% this week. But with profits down year-on-year by around 30% and loan provisions still rising, could this sector be more at-risk than investors care to admit?

Trim these stocks on strength

Pre-earnings, **TD Bank** (TSX:TD)(NYSE:TD) remained flat, indicating that the jury was out on the country's second-largest moneylender. What's interesting about TD Bank's share price this week, though, is that it had been up 3% over the five days preceding BMO and Scotiabank's reports, suggesting that the mixed performance turned in by Scotiabank and BMO was enough to freeze sentiment in TD Bank.

TD Bank, having topped expectations on Thursday, subsequently didn't move too much, though it sat on five-day gains of 7%. **CIBC** saw a bit more action during the day, climbing 1.4% after its own positive report. This also brought CIBC up to a five-day climb in the 7% range. What all of this suggests is that investors, while satisfied with estimate beats, are going to be looking for a bit more from bank stocks going forward.

These stocks are looking like names worth trimming. Investors should check their exposure to Canadian financials and consider trimming the fat. With other risk factors yet to impact the market, Big Five shares could come in for ideal derisking targets in a stock portfolio. Bullishness is keeping these names positive (even Scotiabank bounced back quickly). But this trend may prove unsustainable as the remainder of an embattled 2020 unfolds.

More market risk factors are still coming in to roost

I've been calling for a "wait and see" approach to Canadian banks during this earnings season. There is still too much uncertainty in the pipeline. The true picture of the mid-pandemic financials space has yet to emerge, while loss provisioning is still going up. There is also the expiration of a lot of deferrals coming up in October, and then the U.S. election in November. Neither augurs a promising outlook.

All of this has the potential to hit banks during the next earnings season. That's why investors operating on a long-term basis may want to hold off for the Q4 results. If anything, investors should be looking to take certain names off the table before a frothy fall. Trimming BMO while it's strong could be a good move. Scotiabank could also trend lower later in the year, making for another area to trim some fat ahead of Q4 results.

Since the coronavirus is affecting Latin America later than some other markets, Scotiabank – with its heavy Pacific Alliance exposure – is feeling the pain later than other banks, which means that of all the Big Five Canadian banks, Scotiabank's high tide mark for the pandemic falls theoretically later in the financial year. This may not bode well given those other risk factors also due to hit the sector in the fall.

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